

TO: State Directors
Rural Development

ATTN: Multi-Family Program Directors/Coordinators and
Rural Development Managers

FROM: Arthur A. Garcia *(Signed by Arthur A. Garcia)*
Administrator
Rural Housing Service

SUBJECT: Allowable Administrative Expenses

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to clarify what constitutes an allowable project administrative expense.

COMPARISON WITH PREVIOUS AN:

This AN replaces RD AN No. 3804(1930-C) dated November 22, 2002. Clarifications were made regarding association dues allowed to be paid by project funds and to the task chart regarding fidelity bond coverage.

IMPLEMENTATION RESPONSIBILITIES:

Section 1930.106 of RD Instruction 1930-C states that project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under Agency regulations. Any party not meeting these responsibilities may be subject to penalties. It is expected that only typical and reasonable expenses be incurred for the services

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Preceding RD
Instruction 1930-C

rendered. Consequently, methods to inflate, duplicate, obscure, or failure to disclose the true nature and cost of work performed for the services rendered will cause the Agency to deny budget requests for the services or issue a demand for recovery and reimbursement for unauthorized actions.

Management Plans and Agreements must describe if administrative expenses are to be paid from the management fee or paid for as a project expense.

Agency officials should review budgets for reasonableness, taking into consideration the manner in which the project is managed as described in the management plan and management agreement. A management plan is required for all projects by section 1930.108 of RD Instruction 1930-C. A management agreement is required by section 1930.108 when the management is from other than the borrower. The management agreement should describe administrative expenses paid from management agent fees or project operations. The management plan and management agreement should provide job descriptions for the site manager, the management agent, and other personnel. It is important that these documents accurately reflect the duties being performed by the various personnel. Deviations from the sample management agreement in Exhibit B-3 of RD Instruction 1930-C should be clearly disclosed to the Agency for the Agency's required prior approval.

The management plan must meet the standards set out in Exhibit B-1 of RD Instruction 1930-C. The management agreement must meet the standards set out in Exhibit B-2 of RD Instruction 1930-C. The sample management agreement in Exhibit B-3 of RD Instruction 1930-C may be used in meeting these standards.

A task list should be used to identify which services are included in the management fee, which services are included in project operations, and which are pro-rated along with the methodology used for pro-rating of expenses between management agent fees and project operations. A sample property management services task chart and description is provided as Attachment A to this AN. It provides a listing of expenses typically incurred. The sample chart describes services commonly included in the management fee (Agent Responsibility) and those commonly listed as project expenses (Property Responsibility). Some property responsibilities are completed at the property and some offsite. Agent responsibilities may be performed at the property, the management office, or at some other location.

Disputes may arise as to who performs certain services. The management plan, management agreement, and job descriptions should normally provide sufficient clarity to avoid or resolve any such disputes; however, sometimes clarifications and supporting materials may be required to resolve disputes. The task chart may be used in resolving disputes but ultimately the decision must be made based on the most complete evaluation of the facts presented.

Determining if Expenses are Reasonable.

State Office officials are responsible for meeting the provisions set out in section 1930.117 of RD Instruction 1930-C. When reviewing budgets for reasonableness and determining what constitutes acceptable and unacceptable administrative expenses, it is appropriate to be aware of industry practices for the area.

Section 1930.117 of RD Instruction 1930-C sets out Agency responsibilities. Agency officials are responsible for monitoring compliance with Agency regulations and reviewing and taking prompt action on budgets submitted for approval. The monitoring and oversight must be conducted in a manner that is effective while avoiding micromanaging the project. A management agent's operations should be visited for review of overall budgetary practices for project operations. Such reviews may be the most appropriate means to detect inappropriate charges on a systematic basis for small administrative expenses appearing as reasonable on an individual project basis that would be discovered to be substantial when applied to multiple projects over time.

In balancing the monitoring and oversight responsibilities with available resources for effective and timely servicing of the borrower's account, it is appropriate to review budgets to detect significant unnecessary expenditures while avoiding an in-depth review of minor expenditures when overall administrative expenditures appear reasonable. Reviewers should be aware of the indicators of high administrative expenses.

Recent program internal reviews and audits disclose practices of activities that show disparity in what are considered authorized and appropriate administrative expenses necessary to meet the actual operational needs of the property. Administrative expenses for project operations exceeding 23 percent, or those typical for the area, of gross potential basic rents and revenues (i.e., referred to as gross potential rents in industry publications), highlight a need for closer review for unnecessary expenditures. Budget approval is required and project resources may not always permit an otherwise allowable expense to be incurred if it is not fiscally prudent in the market.

Examples of Abusive Practices.

It is important to know whether the rent ranges are based on subsidized rents when evaluating budget approval actions. Where cash flow shortages are evidenced, proposed expenditure items may be disallowed if they are not fiscally prudent.

- Instances have been identified where it is apparent that the project is being charged for administrative expenses that are required under the management plan and agreement to be paid from the management fee. The management agreement states the services and supplies are included in the management fee, but the practices of the company are not in accordance with the agreement. For example, the sample management agreement provided in Agency instructions provides for management fees to cover labor and associated supplies for the services identified, but the practice of the management agent is to bill supplies to the project and have management fees cover labor only. Such practices result in double payments.
- In addition, practices of mark-ups of supplies or vendor services without any accompanying value added for the services rendered is an abusive practice. An example is a management company purchasing a stove wholesale and marking up the price to reflect a rate at or near retail and billing the project at the higher level without any other value added.
- Another abuse includes obtaining bids for services from several vendors, using the lowest bid and description of services, and undercutting it slightly with an Identity of Interest (IOI) vendor, and then performing poor quality work. This practice undermines the integrity of the bidding requirement. Bids received from IOI bidders should meet the same standards, timeframes, and requirements for selection as all other bidders to be

considered a bona-fide bid, whenever bids are used. It should be recognized that identity of interest bids can evidence the most cost effective services when bids are received on a fair and equitable basis and successful IOI bids are permitted to be approved in such circumstances.

- Abusive practices also involve laundry leases whereby inappropriate reimbursements are made. For example, in exchange for an exclusive right to a long-term laundry lease, parties having identity of interest relationships enter into inappropriate contracts calling for the profits normally paid to the project to be diverted to pay the owner or general partner. Another example includes agreeing to reimburse profits or pay fees in exchange for an agreement by an owner, management agent, or general partner to not participate in the laundry lease bidding when laundry services that were previously performed by those parties are bid out.

When Agency officials detect such activities, it may be appropriate to seek legal advice from the Office of the General Counsel (OGC) to determine if the activities represent illegal kickback schemes that divert project revenues for inappropriate purposes.

Excessive administrative expenses can result in inadequate funds to meet other essential project needs including expenditures for repair and maintenance needed to keep the project in sound physical condition. Actions that are improper or not fiscally prudent may warrant budget disapproval and may also warrant a demand for recovery action.

Examples of Inappropriate Practices.

In addition, it is appropriate to highlight some added areas for guidance on certain expenses that are not allowable such as legal fees, association dues, bonuses or monetary performance awards, parties, computer hardware and software, and telephone.

- It is inappropriate to authorize payment for legal services to represent any interest other than the borrower's interest (i.e., representing a general partner or limited partner to defend their individual owner interests is not allowable). Where there is no finding of a borrower's fault, commercially reasonable legal expenses and costs for defending or settling lawsuits (without admission of liability) are allowable.
- Payment of penalties, including opposition legal fees resulting from an award finding improper actions on the part of the owner or management agent is generally an inappropriate project expense. Such expenses are generally paid by the party responsible for violating the standards or by their insurance carriers.
- Association dues allowed to be paid by the project should only be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.
- It is also inappropriate for the project to pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

- Billing the project for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff are also inappropriate.
- It is also inappropriate to bill the project for computer hardware, software, and internet connections that are beyond the scope and size reasonably needed for the services supplied (i.e., purchasing equipment or software for use by a site manager that is clearly beyond that needed to support project operations). Note that computer learning center activities benefiting tenants are not covered in this prohibition.
- It is inappropriate to bill the project for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

To summarize, expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes. If such value is not apparent, the service or expense should be examined.

Allowable Administrative Expenses.

On the other hand, it is permitted to show allowable administrative expenses that are reasonable and typical on RD Form 1930-7, "Multiple Family Housing Project Budget," under Part II (i.e., Line 19, Site Management Payroll, Line 29, Health Insurance and Other Employee Benefits, Line 30, Payroll Taxes, and Line 31, Workman's Compensation). Payroll related administrative expenses are allowable project expenses (i.e., payment of taxes, liability insurance etc.). Additionally, it is permissible and prudent to ensure budgets reflect adequate working capital. Cash-on-hand at year-end should reflect a positive figure without resorting to curtailing reasonable management fees, administrative expenditures, reserve deposits or an owner's return on investment, as a condition to approve a positive cash-on-hand at year-end on the budget. It is generally not appropriate to require working capital to be spent down prior to considering rent increases unless the unrestricted working capital is excessive.

Postage expense to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, and report submittals to various regulatory authorities for the managed property are allowable project expenses no matter what location or point of origin the mail is generated. Photocopying or printing expenses related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters, are allowable project expenses no matter what location or point of origin the work is performed including outsourcing the work to a professional printer.

Correspondence or reports required for record retention or program compliance are allowable project expenses. The cost or expense of equipment and any related equipment service contracts is a management agent direct expense, unless the machine becomes the property of the project after purchase.

In order to provide greater clarity and uniformity in what is considered appropriate administrative expenses, Attachment A is a guide to divide the tasks between management agents and project operations. Attachment B discusses costs and services typically paid from the management fee. Attachment C covers costs and services to be paid from project income.

Questions may be directed to Janet Stouder of our staff, 202-720-9728.

Attachments A, B, and C

SAMPLE PROPERTY MANAGEMENT SERVICES TASK CHART

Property Tasks	Property Resp.	Agent Resp.	Property Tasks		Agents office
			Must be done at Property	Possibly done offsite or at Property	
Application & Lease Processing					
Show Apartments	X		X		
Take Applications	X			X	
Waiting List preparation	X			X	
Review & Disposition of Applications	X			X	
Notify Applicants of Disposition	X			X	
Tenant Certification & Recert Prep & approval	X			X	
Tenant Certification & Recert Transmittal	X			X	
Preparing Lease & move-in Documentation	X			X	
Re-certification Notices	X			X	
Project Worksheet Preparation	X			X	
Monthly Rental Assistance Request	X			X	
Other Notices (Landlord Tenant)	X			X	
Site Maintenance					
Site maintenance	X		X		
Site Maintenance Work Order Preparation	X			X	
RFP/Bid Spec/Vendor Coordination	X			X	
Site Utilities	X		X		
Accounting					
Rent Collection & Posting	X			X	
Vendor Payment preparation	X			X	
Vendor Accounts payable-Preparing Checks	X	X			X
Distributing Checks	X			X	
Administrative					
Site management payroll	X			X	
Site Management Benefits (Medical Insurance, Dental Insurance, etc.)	X			X	
Employer's FICA/Medicare Matching Taxes	X			X	
Worker's Comp Expense - Tied Directly to Payroll	X			X	
Payroll fees (i.e., ADP, Paychex, Employee Leasing)	X			X	
Maintain Site Employee Personnel Records		X			X
Approve Time Sheets and Prepare/Process Payroll worksheets		X			X
Administer Rate of Pay and Track Time Off		X			X
Auditing expense	X			X	
Legal Expenses	X			X	
Advertising – Property & Employment	X			X	
Property Telephone & Loan Distance Tolls	X			X	
Property postage, Supplies & Copying	X			X	
Site Management Training	X			X	
Resident newsletter/programs	X			X	
Taxes & Insurance					
Property Taxes Administration		X			X
Tax Preparation –Federal Tax Return & Related K-1's	X			X	
Tax Preparation – Tangible	X			X	
Annual License & Required Fees	X			X	
Insurance Expense (Property, Liability, fidelity bonds for on-site personnel)	X		X		
Property Insurance Administration (fidelity bond for centralized staff)		X			X
Information Systems					
Information Systems – Property	X			X	
Information System – Agent Office		X			X
Property Management Oversight					
Regional Managers Time		X			X
Regional Managers Travel		X			X
Regional Managers Benefits		X			X
Property Administrative Support					
Program Compliance – USDA Rural Development		X			X
Responding to Supervisory & Compliance Visits		X			X
Management Plan & Agreement Preparation		X			X
Management Procedure & Forms Preparation		X			X
Review & Implement Regulation Changes		X			X
Budget & Capital Replacement Plan preparation		X			X

Reserve Withdrawal Request		X			X
Servicing Workout Plans Preparation		X			X
Section 504/ADA/Fair housing	X			X	
Program Compliance-LIHTC, Other Approved Financing		X			X
Program Annual Reporting and Monitoring Fees - Other Financing	X				X
Responding to Other Funding Reviews		X			X
Prepare Other Funding Program Reports		X			X
Investor Reporting		X			X
Asset Management/Cash Management Issues		X			X

ATTACHMENT B

COSTS AND SERVICES TO BE PAID FROM THE MANAGEMENT FEE

The following items and services are provided in return for the management fee:

- A. Supervision by the management agent and its staff (time, knowledge and expertise) of overall operations and capital improvements of the site.
- B. Hiring, supervision and termination of on-site staff.
- C. General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all on-site employees including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and workers compensation reports and other IRS or state required reports.
- D. Training provided to on-site staff at the project site.
- E. Preparation and submission of proposed annual budgets and negotiation of approval with RHS, HUD or other governmental agencies and the borrowers.
- F. Preparation and distribution of Rural Housing Service (RHS) Department of Housing and Urban Development (HUD), Housing Finance Agency (HFA), or other governmental agency forms and routine financial reports to Borrowers, RHS, HUD, HFA or other governmental agency.
- G. Preparation and distribution of required year-end reports to RHS, HUD, HFA's or other governmental agency and borrowers.
- H. Preparation of requests for reserve withdrawals, rent increases or other required adjustments.
- I. Arrange for preparation by outside contractors of energy audits and utility allowance analysis. Implement appropriate changes.
- J. Prepare and implement Affirmative Fair Housing Plans as well as general marketing plans and efforts.
- K. Review tenant certifications and submit monthly rental assistance requests, overage and monies collected for occupancy surcharge. Submit payments where required. (Project Worksheets).
- L. Preparation, approval and distribution of operating disbursements and oversight of project receipts and reconciliation of deposits.
- M. Overhead of management agent including:
 - Establish, maintain and control an accounting system sufficient to carry out accounting supervision responsibilities.

- Maintain agent office arrangements, staff, equipment, furniture and services necessary to communicate effectively with the properties, RHS, HUD, HFA or other governmental agency and with the borrowers.
 - Postage expenses related to the normal responsibility for mailings to the properties, RHS, HUD, HFA's or other governmental agency, the tenants, the vendors and the owners.
 - Expense of telephone and facsimile communication to the properties, tenants, RHS, HUD, HFA or other governmental agency and the borrowers.
 - Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.), directly related to protection of the funds and records of the borrower.
 - Central office staff training and ongoing certifications.
 - Maintenance of all required profession and business licenses and permits. (This does not include project site office permits or licenses).
 - Insurance coverage for agent's office and operations (Property, Auto, Liability, E&O, Casualty, Workers Compensation, etc.).
 - Travel of agent staff to the properties for on-site inspection, training or supervision activities.
 - Agent bookkeeping for their own business.
- N. Attendance at meetings (including travel) with tenants, owners, and RHS, HUD, HFA or other governmental agency.
- O. Development, preparation and revision of management plans or agreements.
- P. Coordination of HUD certifications or vouchers with tenants including all reporting to all pertinent agencies and borrowers.
- Q. Directing the investment of project funds into required accounts.
- R. Maintenance of bank accounts and monthly reconciliations.
- S. Preparation, request for and disbursement of borrowers initial operating capital (for new projects) as well as administration of annual owner's return on investment.
- T. Account maintenance, settlement and disbursement of security deposits.
- U. Working with third party auditors for initial set-up of audits and annually thereafter for audit preparation and review. Assist with supplemental letters and preparation of RD Forms 1930-8 as well as other RHS, HUD, HFA or other governmental agency reports.

- V. Storage of records and adherence to records retention requirements.
- W. Assist on-site staff with tenant relations and problems. Provide assistance to onsite staff in severe actions (eviction, death, insurance loss, etc.).
- X. Oversight of general and preventive maintenance procedures and policies.
- Y. Development and oversight of asset replacement plans.
- Z. Oversee preparation of section 504 reviews, development of plans and implementation of improvements necessary to comply with plans and section 504 requirements.
- AA. Reporting to general and limited partners and State agencies for LIHTC compliance purposes.

ATTACHMENT C

COSTS AND SERVICES TO BE PAID FROM PROJECT INCOME

There are generally accepted project expenses that may be paid out of the project operating account. These expenses are listed below.

- A. Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This will include managers, maintenance staff and temporary help for both positions and can including the following specific items:
 - Gross salary
 - Employer FICA contribution
 - Federal unemployment tax
 - State unemployment tax
 - Workers compensation insurance
 - Health insurance premiums
 - Cost of fidelity or comparable insurance
 - Leasing, performance incentive or annual bonuses
 - Direct costs of travel to off-site locations by on-site staff for property business or training
 - Retirement benefits
- B. Legal fees directly related to the operation and management of the Property including tenant lease enforcement actions, property tax appeals and suits, all legal documents, and other project relevant matters.
- C. All outside account and auditing fees, if required by RHS, directly related to the preparation of the annual audit, partnership tax returns and 401-K's, as well as other outside reports and year-end reports to Rural Housing Service (RHS), Department of Housing and Urban Development (HUD), Housing Finance Agency (HFA), or other governmental agency.
- D. All repair and maintenance costs for the project including:
 - Maintenance staffing costs and related expenses.
 - Maintenance supplies.

- Contract repairs to the projects (heating and air conditioning, painting, roofing, etc.).
- Make ready expenses including painting and repairs, flooring replacement and appliance replacement as well as drapery or mini-blind replacement. (Turnover maintenance).
- Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.
- Costs of snow removal.
- Costs of elevator repairs and maintenance contracts.
- Costs of section 504 and other Fair Housing compliance modifications and maintenance.
- Costs of landscaping maintenance, replacements and seasonal plantings.
- Costs of pest control services.
- Other related maintenance expenses.

E. Specific costs that may be charged to the project include:

- The costs of obtaining and receiving credit reports, police reports and other checks related to tenant selection criteria for prospective residents.
- The cost of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.
- All bank charges related to the property including purchases of supplies (checks, deposit slips, returned check fees, service fees, etc.).
- Costs of site based telephone including initial installation, basic services, directory listings and long distances charges.
- All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV and telephone books.
- Postage and delivery costs from the site including expenses to RHS, HUD or other governmental agencies, tenants, verifying third parties, central management offices, etc.

- Partnership or corporate business expenses including state taxes and other mandated state or local fees as well as other relevant expenses required for operation of the property by a third-party governmental unit. Costs of continuation financing statements and site license and permit costs.
- Expenses related to site utilities including actual costs and surcharges as well as deposits and expense of utility bonds in lieu of bonds.
- Site office furniture and equipment including site based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by RHS).
- Real estate taxes (personal tangible property and real property taxes) and expenses related to controlling or reducing taxes.
- All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.
- Costs of collecting rents on-site including bookkeeping supplies and recordkeeping items.
- Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies and other associated expenses.
- Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.
- Tax Credit Compliance Monitoring Fees imposed by HFAs.
- All insurance deductibles as well as adjuster expenses.
- Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.).
- On-site training pre-approved by RHS provided by outside training vendors.
- Site manager salary for additional hours associated with congregate housing.