

Capital Needs Assessment

Lead Agency: HUD

Participating Offices: Treasury-IRS, USDA-RD, HUD-MF, HUD-PIH, HUD-CPD, HUD-OSHC

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Issue Statement: Federal agencies and programs currently have different requirements for what constitutes a valid Capital Needs Assessment (CNA). While some of these differences are necessary consequences of using CNAs for different purposes, administrative alignment of minimum requirements and standards of CNAs across Federal rental housing programs will help avoid duplicative studies if owners and developers introduce a new Federal funding source to the project. In addition to CNAs completed for a specific action or transaction, some CNAs are completed for property and portfolio assessment, long-term capital planning, and asset management purposes, which translate into a different overall scope. Minimum qualifications for providers of CNAs are inconsistent across agencies and programs, and in some cases, are non-existent. Finally, CNAs today generally do not capture utility consumption data that would allow measurement, benchmarking, and establishment of baselines.

Proposed Alignment(s):

Alignment(s) summary: The participating Federal agencies will direct and procure the development and implementation of a new, single CNA template tool for use by Federal and State agencies that administer rental housing program funds that require CNAs. The CNA template will include the actual CNA assessment tool, protocols for its use, reporting requirements, and minimum professional qualifications for the providers performing the CNA reviews. The CNA template will include a traditional, comprehensive property evaluation, an assessment of green building and energy efficiency needs and opportunities, and a utility data collection component. HUD and USDA will adopt the CNA template as the standard required protocol for all programs currently utilizing or requiring CNAs, while Treasury/IRS will share the CNA protocols and template tool as a 'best practice' with State Housing Finance Agencies (HFAs) that administer LIHTC, through the National Council of State Housing Agencies (NCSHA), for potential use by HFAs in administration of their programs.

These recommendations are based on a detailed assessment of the requirements, standards, and components of several CNAs currently in use by the participating agencies and some major lenders, as well as a review of a NCSHA report on CNA recommended practices for State LIHTC providers. The CNA team's outreach efforts on this alignment initiative have received overwhelmingly positive feedback from subject matter experts and stakeholders, including property owners and owner associations, lenders, State administrators, and CNA providers.

Specific actions to effect alignment: Two primary actions will most effectively advance the CNA alignment effort:

1. Creation of a single CNA template tool for use by entities that administer Federal rental housing funds, in the form of an electronic model (e.g., Microsoft Excel workbook, web-based software application, Oracle application, or other [TBD]) designed to allow housing developers and agency users to access

pages in the template that are specific to funding sources or programs. Upon opening the template and selecting the agency or program that is requiring the CNA, the template will show the pages appropriate to that program and the level of CNA review and analysis required for that program.

This single template CNA tool will include:

- An assessment of all building systems, components, and elements to determine current needs and a standard 20-year projection of physical needs.
- A data collection page to record (often for the first time) information critical to efforts to benchmark performance for properties relative to their peers, in order to establish baselines for measurement of future performance. Data collection points and protocols will be consistent with industry-accepted standards, and will include utility configuration options (who pays for which utilities), fuel sources and costs, water and sewer costs and responsibilities, and whole-building utility consumption data, normalized for weather and occupancy variances.
- Two levels of review and analysis. Agencies would require the assessment level most appropriate to fulfill the needs of the applicable program.
 - **Level 1:** Agency programs using the CNA for asset management purposes, capital needs assessments, portfolio reviews, and purposes other than specific rehabilitation planning, will presumably require the Level 1 CNA review. Level 1 will be less expensive than Level 2 to complete, and will have less action-oriented recommendations than a Level 2 analysis, but would include the primary elements of energy efficiency, green building, and life cycle analysis to facilitate informed future decision making about underlying properties.
 - **Level 2:** In general, programs using the CNA to support property development, rehabilitation, refinancing and repositioning, long-term capitalization and capital planning, and energy efficiency and green building retrofits, will presumably use Level 2, which would be the most rigorous level of CNA review and analysis. Two CNA standards in use today illustrate the approximate scope of review proposed for Level 2 of the new CNA template – the Enterprise Green Communities program CNA protocols and the HUD Recovery Act/Green Retrofit Program CNA model.
- The CNA template will build in life cycle cost analysis for all CNAs to allow users to consider these attributes when determining the size of reserve accounts and to assist in investment decisions that may result in reducing utility costs going forward.
- The standard template CNA will include built-in analytics and logic models to enable the tool to make recommendations about the most cost-effective solutions to needs identified through the assessment. These analytics would include:
 - Cost-benefit /payback analyses
 - Early replacement analyses

- 'Cradle to grave' review of materials and components, to the extent possible and as this information becomes more widely available
- Other environmental benefits of systems and components, such as indoor air quality benefits, recycled content, recyclability, durability/useful life, etc
- Origin of materials and local sourcing
- It is important to note that while the CNA template will include the sophisticated analytics and logic to develop recommendations (as described above):
 - All recommendations made by the tool can be manually overridden by the user, for any number of reasons (i.e., cost constraints, availability of materials, physical constraints, etc). A built-in audit function will allow the user to view an inventory of overridden fields.
 - The CNA review may identify a need for further supplemental, specialized assessments such as lead-based paint testing, an ADA accessibility study, asbestos review, feasibility testing for some alternative energy installations, underground storage tank testing, etc. The CNA itself will not include these specialized assessments, but will include 'flags' to alert the CNA provider to the potential need for further studies, either because of the funding source requirements or because property characteristics warrant further study.
 - The template CNA will assess and report on the physical needs and opportunities at the subject property, but will not require any work to be completed. Any requirements for action to be taken based on the CNA report will be driven solely by the agency and/or program utilizing the tool. In other words, the CNA tool provides the assessment but the agency/program applies its rules to the use of the CNA tool and the actions that may be required to address the assessment.
 - Any agency using the template CNA can exercise its discretion to waive or modify the CNA requirements for very small properties, where the cost of assessment would be prohibitive.
- The CNA may include a link between the CNA template and an online industry source for accurate and current construction cost data and estimated useful life (EUL) tables for materials and building systems that will be maintained and updated on an annual basis, to improve the accuracy and consistency of CNAs across all users.
 - It may also be possible to retain an outside contractor to link the CNA template to accurate and current construction cost data, and to maintain this data on an annual basis. This would greatly improve the accuracy of CNAs across the country.
- Further adaptation of these standards by the agencies could be additive but presumably not be subtractive, i.e., the minimum assessment standards would apply in all cases, but some agencies or programs may layer additional requirements beyond the CNA review.

Capital Needs Assessment Tool and the HUD-PIH Physical Needs Assessment Tool

Currently, HUD-PIH is working on the development of a Physical Needs Assessment (PNA) tool which will be used by Public Housing Authorities (PHAs) for capital planning. The HUD-PIH capital planning PNA is being created based on a CNA constructed by HUD-MF's Office of Affordable Housing Programs (OAHP) for its Green Retrofit program. Pilot testing slated for the summer of 2011, and roll out to all PHAs in 2012.

The HUD-PIH PNA is anticipated to be very closely aligned with the CNA. The major difference between the two products relates to the level of complexity and associated burden, and the level of control the agency has in the process. The HUD-PIH PNA will be completed by PHAs every five years and updated annually by over 3,100 PHAs, including some 2,100 small PHAs. However, the CNA tool is intended to be transactional, and thus would be undertaken by a much smaller subset of entities much less frequently, potentially only once every 15 or 20 years.

PHAs would only infrequently use the CNA tool for capital planning as the level of sophistication and complexity associated with it would be greater than with the PNA. It should be noted however that the CNA protocol would apply to HUD-PIH transactional programs (such as Choice Neighborhoods or Public Housing Capital Grants) that typically require CNAs. Major recapitalization and substantial rehabilitation events generally require borrowers to meet a higher standard to justify the long term commitments implicit in the financing.

CNA training

Development and adoption of a single CNA template tool will require a robust training and implementation component for users. This training will include, at a minimum, a comprehensive user guide, in-person training for respective agency staff, regional in-person training for CNA providers and other stakeholders, and a webinar (or potentially multiple webinars targeting various stakeholder audiences) conducted jointly by the agencies and the contractor responsible for development of the template, as part of its overall engagement. This webinar training will continue to be available nationally, and archived for future use by anyone, accessible on the respective agencies' websites. CNA providers using existing CNA templates have emphasized the critical need for training and technical assistance, as the learning curve for a new tool and protocol (even for experienced providers) can be steep. Additionally, the presumed streamlining savings anticipated are dependent upon up-front training.

2. In conjunction with the new CNA template tool, the team proposes development of a minimum professional qualification standard for providers of CNAs, to ensure that providers have the experience and ability to assess the capital needs of rental housing properties. The CNA template proposed is more in depth than some CNA protocols in use today, including the energy audits/assessments, life cycle cost analysis, and accessibility standards components, each of which requires specific knowledge and experience. It is critical that the new CNAs are completed by professionals capable in these areas so that assessments are correct and usable. The common qualification standard will likely reference

and accept any number of broadly available industry qualifications, standards, certifications, or accreditations.

Resource Estimate for Implementation: Based on CNA team research into the resource requirements to develop other CNAs currently in use by other parties, the team estimates that the total cost to design, develop, implement, provide training on, and maintain the CNA template tool would be approximately \$1 million - \$1.5 million. This estimate includes procurement, design, development, testing, training development, training delivery, implementation and roll out of the CNA electronic tool, and associated protocols, user guide, and training materials. This total cost breaks down approximately as:

- CNA design and development: \$0.8 - \$1.25 million. This estimate assumes that one or more of the existing CNA templates can be used as a basis for design and development
- Implementation, training, technical assistance, user guide development: \$0.25 - \$0.5 million

It is critical that the full range of activities associated with the initiative is funded together.

This investment is recommended to be a shared cost between two of the Rental Policy Working Group lead agencies. HUD, as the most intensive user of CNAs, will assume the largest share of cost, with USDA assuming part of the responsibility commensurate with demand. Because Treasury works to provide guidance to State HFAs, but does not otherwise provide resources with which State HFAs are to administer the LIHTC program, Treasury/IRS may issue guidance related to the CNA tool but will not require HFAs to make the new CNA a required component of HFAs allocation process and will not contribute to costs of development. This initiative includes elements of Information Technology, Technical Assistance, and Transformation, and the team recommends pooling resources from each of these areas in the respective Agencies. This resource allocation is a strategic investment in a tool and protocol that will streamline operations, and save considerable Agency and stakeholder resources in the long run.

Estimated cost savings for owners, operators, developers, investors and/or lenders: Cost savings are anticipated as providers of CNAs gain familiarity with the standardized requirements of CNAs across agencies. While difficult to estimate, the standardized CNA template tool could conservatively be expected to save 10-20% on the cost of an average, comparable CNA assessment and report, primarily due to the efficiencies of a standardized assessment approach. CNA providers, regardless of agency, program, or location of the property (depending on which State LIHTC administrators adopt the standard CNA), will be familiar with the tool, protocols, and expectations of the assessment.

Streamlining for providers should result in reduced costs to the consumers of the reports, i.e. the owners, developers, lenders, and/or investors. A back-of the envelope estimate of potential savings assumes approximately 3,000 CNAs are performed per year in the various HUD, USDA, and LIHTC refinance and/or rehab programs' assisted or subsidized properties. At an average cost of \$10,000, and a conservative, average assumed efficiency savings from using this new CNA template of 10%, annual savings from this alignment will be $(3,000 \times \$10,000 \times 10\%) = \3 million.

The CNA tool will include, as described, cost/benefit analyses and life cycle cost analyses, informing investment decisions in components and technologies that will result in measurable savings generated

from utility and water efficiency savings. These savings may accrue to the owners, investors, lenders, agencies, and/or residents, depending upon utility configuration, subsidy structure, etc.

Savings to stakeholders will also result from the elimination of the need for duplicate CNAs on the same transaction. For example, a property currently may need to meet one CNA standard for an agency (HUD or USDA) and another standard for the State administrator of LIHTCs, requiring two similar but distinct CNAs to be produced. Additionally, equity investors and lenders may continue to require their own independent CNAs. Properties subject to multiple program requirements across multiple agencies may similarly be required to produce (and pay for) multiple CNAs to satisfy each agencies' unique requirements.

Estimated cost savings for State, local, and Federal governments: The single CNA template will simplify future coordination and updates to all of the agencies' CNAs, as regulations and requirements change, energy efficiency advancements are made, and new components and technologies become available, all of which will affect the rental housing industry and will be reflected in future versions of the CNA tool. Currently, HUD and USDA hire outside contractors to separately develop, update, and maintain these various templates. These costs average more than \$1 million per year. When there is only one standard template, there will be savings by reducing overlaps in work between agencies to keep templates updated.

The CNA tool will include, as described, cost/benefit analyses and life cycle cost analyses, informing investment decisions in components and technologies that will result in measurable savings generated from utility and water efficiency savings. These savings, while difficult to estimate, should equate to tens of millions of dollars per year in the near term; HUD and USDA alone spend in excess of \$6 billion annually on utilities in some form (i.e., tenant utility allowances, inclusive rents, budget-based operating subsidies, etc). CNAs that drive owners and investors to make efficiency investments that result in very modest utility savings of 10-20% will generate millions in savings in a very short time. (These savings are very achievable: EnergyStar requires a standard that is 15% more efficient than local code, and experience in some HUD retrofit programs has shown that 20% savings are readily realized with modest investment.) The long-term goal is to utilize a CNA that includes an energy audit component, as recommended here, to make the agencies' portfolios much more efficient and affordable over time.

The agency program administrators that utilize the CNA reports and recommendations to support programs will benefit through saved staff time by having a standardized tool; currently, the lack of a standard format for presentation of CNA findings and recommendations result in a great deal of back-and-forth between the agency staff and the CNA provider. A standard tool with a clear and explicit protocol for reporting and on which all parties are trained will greatly reduce the time and effort to successfully complete a property assessment.

Finally, the CNA tool, if linked to cost-estimating software or data, will save agency time and money (as well as owner/investor time and money) through more accurate and timelier cost estimating and capital planning than can be performed currently.

Schedule for Alignment Implementation: The total development and implementation time for the single, multi-agency CNA template is estimated to be 24 months. Thus includes:

- Development of specifications and scope of work: 3 months
- Procurement of services: 3 months

Major Milestone at 6 months: Contract procured/Contractor selected for development of CNA

- Design and drafting of detailed template functionality and interface specifications with selected contractor: 4 months
- Development of beta version of template tool: 4 months

Major Milestone at 14 months: Beta tool developed for testing

- Testing, revisions, finalization of template tool: 3 months
- Limited release for final testing: 2 months
- Creation of user guide, training materials, on-line training sessions, technical assistance materials, etc: 3 months (concurrent)
- Finalization of template tool: 1 month

Major Milestone at 21 months: Final tool and training materials released; training begins

- Public release of final CNA template tool, training for agency staff, CNA providers: 3 months (and ongoing via on-line training materials)

Major Milestone at 24 months: First round of training for agency staff and CNA providers completed, archived webinars and training materials available for public use

It is recommended that participating agencies adopt the CNA template for all programs requiring the use of a CNA within six months of public release of the template.

Challenges to effecting proposed alignment(s):

Stakeholders have raised concerns that a CNA template and protocol that involves more rigorous review and reporting requirement than may currently be required, such as the addition of an energy audit component, will lead to increased costs per CNA.¹ These are legitimate concerns, as some agency programs that convert to the new template CNA will increase the rigor of the review and likely the cost to have a review performed. However, any increase in the rigor of CNA requirements are most likely coming regardless of this alignment initiative. In fact, the aligned CNA template should minimize the cost increases because of the cost-reducing effects of standardization. As detailed above, many programs' CNAs should fall in cost due to the alignment.

A related cost concern raised by stakeholders is that establishing minimum professional qualifications and training requirements for the professionals performing CNAs could, at least in the short term, increase the cost of finding a qualified professional to perform the CNA, particularly in rural areas and for owners that perform CNAs using internal staff who may or may not meet the aligned qualification requirements. While the development of common CNA provider qualifications promotes useful and proper CNA assessments, the enactment of such minimum qualifications or certifications may lead to an increase in the cost of

¹ The savings from efficiencies estimated above are savings over a similar-scope CNA.

providing/attaining a CNA, at least initially until the market catches up to the qualification standard. These challenges are believed to be short term, as the provider industry gets up to speed on qualifications, and that this potential cost increase is more than offset by the savings resulting from standardization.

The use of CNAs to meet the requirements of the various agencies and program offices varies greatly. The development of each of the primary forms of CNAs in use or development by the respective agencies today has been a lengthy and expensive process, involving considerable contract dollars and internal agency resources to guide the development and implementation of the tool. Modifications recommended through this alignment process, if adopted, may result in time-intensive and costly changes to guidance, software, training, and roll-out, which could render their implementation challenging. For example, many public housing authorities (PHAs) have a CNA system in place, either internally or through a third party provider. Some of these third party arrangements involve an ongoing contractual relationship for maintenance of the database created through the CNA. Some of these databases are further integrated into the PHAs other internal operating systems. Further, many PHAs perform the CNA activity for strategic planning with qualified in-house staff; a professional qualification requirement, if greater than today's requirements, would potentially force PHAs to bear the expense of third party providers or of extensive re-training for their staff to obtain professional certification.

Another example comes from the green CNA developed to support HUD's Green Retrofit Program; the tool was developed using an existing HUD CNA tool as the baseline, and considerable time and contract dollars to develop, test, train, and implement the tool. That CNA tool is designed to support a specific program, in that the results of the CNA are automatically electronically linked into the financial underwriting model used to support award decisions, loan and grant sizing, and loan committee reviews.

The development of a single CNA template capable of supporting the specific requirements and nuances of each of the application templates, with the functionality to allow the user to select the agency and program and have the appropriate screens appear, would in itself be a considerable undertaking in terms of agency resources, as described above. Once created and tested, there will be a considerable commitment of time and resources to then provide training and support to the various stakeholders in becoming familiar with the tool. There will be an ongoing need for maintenance and updating the tool, and technical support to the users of the tool.

On the other hand, once in place, this template CNA tool will be easier to maintain and update with newer, more accurate information than multiple CNAs between agencies. With an increased emphasis on energy efficiency in rental housing, energy subsidies would correspondingly be reduced as well.

Despite these challenges, it is the team's collective recommendation that this undertaking is a strategic investment in a tool and protocol that will streamline operations and save considerable agency and stakeholder resources in the long run.

Purpose

This document is part of an ongoing effort to better align Federal rental policy across the Administration and is sponsored by the Rental Policy Working Group. The Rental Policy Working Group is composed of the White House Domestic Policy Council (DPC), National Economic Council (NEC), Office of Management and Budget (OMB), and the U.S. Departments of Housing and Urban Development (HUD), Agriculture (USDA), and Treasury.

The specific areas of concern identified herein emerged from July 2010 stakeholders gathering at the White House on areas of Federal rental policy inconsistency across the administration. The revised conceptual proposals for alignment articulated within this report are preliminary in nature and have not been endorsed by any Federal agency or office.

With any questions, please contact the Rental Policy Working Group Agency Alignment Leads: Larry Anderson, Director of Multi-Family Housing Preservation and Direct Loans at USDA-Rural Development, Ben Metcalf, Senior Advisor at HUD's Office of Multifamily Housing Programs; or Michael Novey, Associate Tax Legislative Counsel in Treasury's Office of Tax Policy.