
CHAPTER 11. SERVICING A PROJECT AFTER EXECUTION
OF THE USE AGREEMENT

Section A.

Introduction and Actions Required After Approval
of a Plan of Action to Prepay

- 11-1. Introduction. Loan Management Staff has the responsibility for monitoring the implementation of approved Plans of Action (POAs). This responsibility includes monitoring the Use Agreement, the Regulatory Agreement, the Grant Agreement, the Section 8 Contract and any other regulatory obligations. This Chapter contains guidelines for carrying out these responsibilities. In most cases, the servicing and monitoring requirements of this Chapter are in addition to the servicing requirements which would have been required if a POA to extend low-income affordability restrictions had not been implemented. Where the requirements of this Chapter conflict with other servicing requirements, the requirements stated in this Chapter will prevail.
- 11-2. Actions After Prepayment Approval.
- A. When a Plan of Action (POA) has been approved to terminate low-income affordability restrictions through prepayment:
1. The owner must:
 - a. Execute a Use Agreement with HUD to maintain the rent levels for tenants living at the project at POA approval. Despite the lack of Section 8 funding, the owner must comply with the Use Agreement until the earlier of the maturity date of the initial mortgage or until all tenants living in the project at POA approval voluntarily move. Both HUD and the tenants have the right to enforce compliance with the occupancy requirements contained in

the Regulatory Agreement, Use Agreement, and HUD Handbook 4350.3.

- b. Limit rent increases for current tenants to the restrictions cited in Paragraph 8-13.A.1. If additional income is needed to cover increased operating costs, it must be derived from increased rents charged to tenants who initially occupy the project after POA approval.

2. The Loan Management staff will:

- a. Inform tenants of the rent protection which HUD and the owner must ensure that they receive, using Appendix 10-1, Notification to Tenants of Acceptance of Prepayment. If, after the owner prepays the mortgage, the tenant is paying rents higher than those allowed by Paragraph 8-13.A.1., the tenant should notify the Loan Management Branch which will take appropriate actions in accordance with Paragraph b. below.
- b. Contact the Preservation Division for further guidance if it has questions about such cases, since Field Offices do not have the authority to take necessary actions.

- B. When an owner is allowed to prepay due to lack of funding or an inability to sell a project, in accordance with Paragraphs 7-14 and 7-15 or Paragraph 8-31, HUD is obligated to regulate rents for certain protected tenants who were living in the project at the time of the Initial NOI submission and who continue to reside at the project. The rents are limited for a period of three years in accordance with Paragraph 10-4.

- 1. The protected tenants are those living in projects located in areas designated as low-vacancy in accordance with Paragraph 11-12 and special needs tenants living in all projects.

2. Rent increases for tenants who remain in the project or to whom the owner provides a replacement unit in another project, will be limited to the application of the Operating Cost Adjustment Factor (OCAF), established in accordance with Paragraph 11-7.C.1., to the portion of the rent attributable to operating expenses. The owner should contact HUD annually to receive the updated OCAF. It may be necessary for the owner to subsidize the rents of tenants to whom they provide a replacement unit, in order to meet this requirement.
 3. If a tenant is paying more than the regulated rent, or if the owner is not providing other required protection, the tenant should notify the Loan Management Branch which will take the appropriate actions. If the Loan Management staff have questions about such cases, they should contact the Preservation Division for further guidance, since the Field Offices do not have the authority to take necessary actions.
- C. Revised Tenant Leases. For all approved prepayments of the mortgages or terminations of mortgage insurance contracts, the owner must propose the language which will be inserted into or appended to tenant leases to advise tenants of the changes in lease terms. These lease terms must specify the protection the owner will guarantee the tenant. This protection must include limitations on rent increases and restrictions on involuntary displacements in accordance with Chapter 10. If the proposed lease language meets these conditions, Loan Management staff will provide written approval to the owner prior to the prepayment. The prepayment of the mortgage may not be accepted until Loan Management staff reviews and approves the lease language. At the discretion of the Chief, Loan Management Branch, Field Counsel advice and concurrence on the lease language may be obtained. The Loan Management staff is relieved of all further monitoring responsibilities for the project and need only investigate if notified of a violation.
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Section B. Projects in Which Low-Income Affordability
Restrictions Have Been Extended

- 11-3. Monitoring Projects after Approval of a Plan of Action (POA) to Extend Low-Income Affordability Restrictions Through Retention or Sale. The date of POA implementation will be the same date the Use Agreement is executed. The Loan Management staff must monitor the project in accordance with the remainder of this Chapter for its remaining useful life.
- A. Projects Which are Sold. Within 90 days of POA approval, the Transfer of Physical Assets (TPA) and the loan must be closed, and the Use Agreement, Amended Regulatory Agreement and Section 8 contract must be signed. LOG date Use Agreement is executed. If the Section 241 loan cannot be closed within 90 days of POA approval, except for reasons beyond the owner's control, HUD will rescind the POA approval and the owner must wait six months before submitting another Initial NOI. Please note that since loan commitments must be obtained prior to POA approval, a lender's inability to close the loan within the required time would not automatically be considered a reason beyond the owner's control.
- B. Projects Which are Retained by the Owner. There is no time limit for the closing of the Section 241(a) or 241(f) loan nor for the execution of the Use Agreement, Amended Regulatory Agreement, and Section 8 Contract.
- 11-4. Tenant Income Profile. Records for tenant income profiles must be maintained at the project office along with tenant income data. The Loan Management staff will review tenant income profiles during occupancy reviews or in response to complaints received, to ensure that the proportion of tenant income levels shown in the profile conforms to that contained in the Use Agreement. This limitation will not prohibit the owner from renting to a higher proportion of very low-income families and persons if it so desires.
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- A. The Loan Management staff must monitor to ensure that the profile requirements are met, to the greatest extent possible, as tenant turnover takes place. That is, tenant selection should result in the same proportion of very low-, low-, and moderate-income families and persons residing in the project as determined in the tenant profile established in accordance with Paragraph 8-27.
- B. A classification of very low-, low- or moderate-income is established for each tenant. The owner classifies tenants residing in the project at POA approval in accordance with Paragraph A. above, or upon occupancy, for those entering the project after POA approval. A tenant's classification remains the same for purposes of the tenant profile for as long as the tenant resides at the project, regardless of subsequent changes in income. Therefore, documentation of the income designation for each tenant must be maintained in the tenant file for as long as the tenant continues to reside at the project.
- C. Tenants, residing in the project at the time the tenant profile was selected and whose incomes exceeded 95 percent of area median income, are counted as moderate-income for purposes of developing the tenant profile. However, other potential tenants, with incomes at or above this level, may not be admitted after POA approval.
- D. All other applicable occupancy requirements of the Multifamily Housing Programs under which the mortgage was insured, which do not conflict with the criteria in Paragraphs A. through C. above, must be met in accordance with HUD Handbook 4350.3, Occupancy Requirements of Subsidized Multifamily Housing Programs. Such requirements must be integrated with the criteria cited in Paragraphs A. through C. above. For example:
1. Separate waiting lists must be maintained for each income category required by the tenant profile.
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2. Within each income category, other preferences and priorities in effect prior to the preservation process, will be maintained.
 - a. Unit Size. Within each income category, tenant selection should be made to meet appropriate unit-size requirements.
 - b. Military and other Federal and Local Preferences. Other preferences will continue to be used, within the appropriate income category and unit size.
3. If a Section 8 unit becomes available (e.g., due to increase in a low-income tenant's income) and is not needed for a tenant designated as very low- or low-income on the tenant profile, it must be assigned in accordance with the occupancy policies established in HUD Handbook 4350.3, Occupancy Requirements.
4. Tenant selection must be done in accordance with established occupancy policy so long as the tenant profile is not violated.
5. Tenant profile waivers, and waivers to admit above moderate-income tenants to the project, will be handled as all other waivers for occupancy.

11-5. Availability of Section 8 Rental Assistance to Tenants. HUD will ensure that the Section 8 Housing Assistance Payment (HAP) Contract has sufficient funding through Section 8 LMSA to provide Section 8 rental assistance for all tenants designated as very low- or low-income on the tenant profile list and for the number designated very low- and low-income families on the tenant profile. HUD will fund the HAP contract at this level even if the entire amount of the rental assistance is not needed at the project immediately after POA approval for reasons such as: (1) the existence of vacant units in the project at POA approval; (2) some of the eligible tenants hold Section 8 vouchers or certificates; (3) the Section 8 gross rent for the unit does not exceed 30

percent of the tenant's AMI; or (4) the number of Section 8 units needed to fulfill the tenant profile requirement is not needed immediately for the current very low- and low- income tenants. The unused portion of the Section 8 HAP contract will be held in abeyance and used as needed. A condition of approval of the POA is that the owner agrees to extend the low-income affordability restrictions at the project throughout the remaining term of the Use Agreement executed in accordance with Paragraph 8-30. The owner will achieve this objective by providing Section 8 LMSA rental assistance for the number of units indicated in the Use Agreement. The Loan Management staff must monitor the project to ensure that the owner honors this commitment.

- A. Eligibility for Section 8 project-based rental assistance is different under the Preservation program from that of other HUD programs in that all tenants designated very low- or low- income on the tenant profile are eligible. The owner must provide the Section 8 LMSA units to all of the very low- and low-income residents who would pay more than 30 percent of their adjusted monthly income (AMI) for total tenant payment (TTP) after approval of the POA, whether the tenant resides in the project at POA approval or satisfies a very low- or low-income allocation on the tenant profile upon entering the project.
 - 1. Tenants who are eligible for Section 8 rental assistance upon POA approval or upon entering the project after POA approval, retain their eligibility for Section 8 rental assistance until they move from the project. If these tenants' incomes increase so that their TTP exceeds the Section 8 Gross Rent, the Section 8 rental assistance may be suspended. However, if income decreases again so that their TTP is lower than the Section 8 Gross Rent, these tenants would be eligible for Section 8 rental assistance at whatever time the assistance is needed to reduce the tenants' TTP. Under Title VI, they must receive first priority for the rental

assistance as soon as it becomes available.

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2. Any tenant who is filling a moderate income tenant profile allocation at POA approval or initial occupancy, and whose income drops below the low-income limit for the area, must meet the Section 8 eligibility requirements in order to receive rental assistance. Since the tenant continues to fill a moderate-income allocation on the tenant profile, Section 8 assistance is not guaranteed.
- B. Section 8 LMSA Total Tenant Payment (TTP).
1. The TTP for tenants receiving Section 8 will be calculated on Form HUD-50059-E. An exception to this policy will apply to tenants living at the project at POA approval where the rent is being phased in pursuant to Paragraph 2 below.
 2. For tenants living at the project at POA approval, if the required TTP represents an increase of over ten percent because the tenant was not receiving Section 8 rental assistance before POA approval ordinarily residents of Below Market Interest Rate (BMIR) Projects, any increase greater than ten percent will be phased in as described in Paragraph 11-8.D. For tenants who are currently being phased up to Section 8 rents (e.g., conversion from rent supplement to Section 8), the current phase-in should continue, and the phase-in due to approval of the POA, will not apply.
 3. As with other Section 8 programs, if the TTP for a Section 8 tenant is a negative amount, the owner will pay the tenant a utility reimbursement.
- C. Number of Units in the Section 8 Contract.
- HUD will not increase the number of units in a project-based Section 8 contract, after POA approval, to accommodate a greater number of tenants who need Section 8 rental assistance after POA approval.

1. If incomes of tenants classified as moderate-income decrease, they may receive Section 8 LMSA rental assistance, if available in the current contract. Those tenants also may receive Section 8 vouchers or certificates, if available. However, to the extent practicable, when a moderate-income tenant's income decreases, the owner must continue to maintain the tenant profile while continuing to designate the tenant as moderate-income, as described in Paragraph 11-4.B. Therefore, it is possible that the tenants whose incomes decrease will not be able to receive Section 8 LMSA rental assistance because it must be given as a priority to tenants designated as very low- or low-income on the tenant profile.
2. Nothing may prevent an owner from renting to a higher proportion of very low-income tenants. However, these tenants would have to fill a moderate-income vacancy on the tenant profile and Section 8 rental assistance, if available, would have to be provided through Section 8 vouchers, certificates, or any unused Section 8 LMSA rental assistance not needed for a tenant designated as very low- or low-income.

D. Tenants with Section 8 Vouchers or Certificates. Tenants who enter the project after POA approval with vouchers or certificates may be designated moderate-income on the tenant profile. Project rents for these purposes will be set at FMR level. It is to the owner's advantage to provide every tenant designated low- and very low-income on the tenant profile, with a Section 8 LMSA unit.

11-6. Total Tenant Payment for Moderate-Income Tenants. Loan Management staff will send the owner a copy of the Existing Section 8 Fair Market Rents (FMRs) whenever changes are published in the Federal Register. They will also send updated information

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changes are issued by the Economic and Market Analysis Division (EMAD). Except for tenants whose rents are being phased in, the owner will use Form HUD-90012, Appendix 11-3, to calculate tenant rents. Moderate-income tenants ordinarily will pay the lower of 30 percent of AMI (In BMIR projects, adjustments to income will be made in the same manner as for Section 236 Projects.) or the FMR for TTP, with the following four exceptions:

- A. After POA approval, rent increases will be phased in, as described in Paragraph 8-18.A.7.
- B. If a moderate-income tenant's income decreases substantially and Section 8 rental assistance is unavailable, the tenant will make a TTP not less than the Minimum Rent, unless the FMR is lower. Minimum Rent will be set at 30 percent of the Section 8 low-income limit for the applicable family size adjusted by family allowances, in accordance with Paragraph 8-18.A.13.
- C. Any tenant who refuses to certify or recertify income, will be charged the FMR. If such a tenant is subject to a phase-in of rents, 30 percent of AMI will be assumed to equal the FMR for the unit type and this amount will be the target rent.
- D. No moderate-income tenant's rent will decrease as a result of the POA approval.

11-7. Determination of Project Rent, General Project Rent Increases and Section 8 Contract and Gross Rents. Paragraphs A. and B. below describe the method for calculating Preservation Project Rent (PPR), Paragraphs C.1. through C.6. describe the method for granting general project rent increases and Paragraph C.7. describes the method for determining Section 8 Gross Rents. Paragraph D. contains additional information relevant to project rent and rent increases.

- A. Annual gross rent potential (GRP) after POA approval is determined in accordance with Paragraph 8-17.C.

- B. Preservation Project Rent may be calculated using lines A. through C. of Form HUD-90011, Calculation of Section 8 Gross Rents in Appendix 11-2. The PPR is derived by adding the sum of the annual utility allowances for all units to the GRP.
- C. Future increases for the annual GRP will be handled in the manner described below. No other rent increases (e.g., for increased operating expenses in mid-year) will be allowed.
1. Each year the EMAD will develop and publish an operating cost adjustment factor (OCAF) based on underwriting considerations and the Consumer Price Index (CPI) for metropolitan areas.
 2. At least 60 days prior to the anniversary of implementation of the POA or the date a later rent increase is desired, the owner should request a determination of the next year's budgeted operating expenses from the Loan Management Branch.
LOG receipt of request With this request the owner will submit requested utility allowances, along with documentation for the amount requested, a profile of the current occupancy of the units and a projection of anticipated occupancy of vacant units, which will meet the tenant profile.
 3. Within 15 days of receipt of the request, Loan Management Branch will apply the most recent OCAF to the portion of the GRP attributable to operating expenses adjusted for vacancies, management fees, etc., and in the case of priority purchasers, to the oversight costs. If non-operating costs increase or decrease, e.g., a loan secured by the project is repaid, the budget will be adjusted for the change. The Loan Management staff must send the owner a letter notifying it of the result. LOG date letter sent

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4. Owner Appeals Operating Cost Adjustment Factor. If the owner finds that the HUD determined rent increase will not cover expenses and wishes to submit a formal appeal to request higher rents, it must do so within 30 days of receiving HUD's notification of the projected GRP. The project oversight costs portion of the submitted budget may never be increased more than the amount which results by applying the OCAF. Also, the percentage of the total rents which may be paid as management fees may not exceed the percentage determined at POA approval. The owner should request and Loan Management staff should evaluate requests for higher rents using the method set forth in Chapter 7 of HUD Handbook 4350.1 Insured Project Servicing Handbook. The resulting rents, if approved, will remain in effect until the following year's OCAF is applied.
5. Using OCAF in Subsequent Years.
 - a. For the second and all subsequent years, the OCAF will be applied by Loan Management staff to the adjusted operating budget amount derived by using the OCAF in the prior year. Specifically, any operating cost increases approved as a result of an appeals process will not be used in determining the GRP for the next year. If the owner determines that the next year's increase will not cover expenses, it must file another appeal. The owner must follow this procedure for all future rent increases until the GRP is at a level where it would have been if all rent increases had been based on application of the OCAF.
 - b. Example:

Budget for Year 1:
Adjusted Operating Costs: \$300,000

For Year 2: OCAF = 1.087

Based on OCAF, adjusted operating costs: $\$300,000 \times 1.087 = \$326,100$

Owner justifies a budget, which is approved with \$350,000 operating costs.

For Year 3: OCAF = 1.069

Based on OCAF, adjusted operating costs: $\$326,100 \times 1.069 = \$348,601$

Owner justifies a budget, which is approved with \$370,000 operating costs.

For Year 4: OCAF = 1.092

Based on OCAF, adjusted operating costs: $\$348,601 \times 1.092 = 380,672$

Expenses based on \$380,672 is used and OCAFs are applied in subsequent years.

- c. The owner may request rent increases based on the application of the OCAFs in accordance with Paragraphs a. and b. above on the anniversary of POA approval even if a previous rent increase request was made late or never made at all. For instance, the owner in the example in Paragraph b. would be eligible for the \$380,672 operating cost even if no rent increase request was submitted in Year 3.
6. Loan Management Staff Calculates Preservation Project Rent. The PPR is calculated at each rent increase by adding the GRP and all utility allowances for the projected year using Form HUD-90011, Appendix 11-2. Increases in the utility allowance will be evaluated at the time of the rent increase. Owners must submit documentation of actual

utility costs to justify the utility allowances requested.

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7. Loan Management staff will apportion Section 8 Gross Rents to the unit sizes to achieve the PPR by using form HUD 90011, Appendix 11-2 as follows:
 - a. Calculate the sum of the annual rents projected to be paid by moderate-income tenants as determined in accordance with Paragraph 8-17.C.2.;
 - b. Subtract the result in Paragraph a. above from the PPR calculated in Paragraph 6. above. For example:
 - i. Assume approved GRP is \$900,000 and the sum of annual utility allowances are \$50,000 for a PPR of \$950,000.
 - ii. Projected rents for all moderate-income tenants are \$5,000.
 - iii. Section 8 gross rents must be established so that they total \$945,000 (\$950,000 minus \$5,000).
 - c. Allocate the amount calculated in Paragraph b. above to the gross rents by unit size using the method outlined in form HUD 90011, Appendix 11-2.
- D. Notification to tenants of rent increases must be handled in accordance with HUD Handbook 4350.3.

11-8. Tenant Rents. The Loan Management staff must monitor tenant rents to ensure continued compliance with all of the above requirements and their interaction. During the rent phase-in period, the owner should use Form HUD-90010, Owner's Calculation of Tenant Rent Phase-In Due to Approval of POA in Appendix 11-1, to guarantee:

- A. Appropriate phase-in of rents, in accordance with Paragraph 8-18.A.7, for tenants whose TTP will increase more than 10 percent;

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- B. Annual tenant recertification;
- C. Project rent increases granted in accordance with Paragraph 11-7 above;
- D. Appropriate interaction of the issues listed in Paragraphs A. through C. above. Form HUD-90010, in Appendix 11-1, is designed to achieve this interaction and enable the owner to calculate the annual phase-in of the tenant's TTP. The steps in this process are as follows:
1. Determining Which Tenants Must Have Rents Phased In. Upon POA approval, the owner will determine which tenants are paying less than both FMR and 30 percent of AMI for TTP. This determination is made because any tenant already paying either 30 percent of AMI or FMR is paying the target TTP and does not need to have rent phased in. Primarily, moderate-income tenants will be identified. However, tenants in BMIR projects who will begin receiving Section 8 rental assistance as a result of the POA approval will also be identified. PLEASE NOTE that in any project in which tenants pay their own utilities, a utility allowance must be established, if none previously existed, in order to determine TTPs.
 2. Determining the Target TTP. The owner will determine a target TTP for each tenant identified as paying less than both FMR and 30 percent of AMI for the TTP. The target TTP is the payment the tenant would be expected to make at the end of the phase-in period if there were no rent increases nor changes in the tenant's income. This is the lower of 30 percent of AMI or FMR.
 3. Determining the Percentage of Income to

be Paid During Phase-In.

- a. The phase-in requirements described in Chapter 8, Paragraph 8-18.A.7 and Paragraphs 1. and 2. above, will be used to determine the percentage of

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income the tenant would pay each year for TTP if there were no rent increases nor a change in the tenant's income. Percentage of income may be used in lieu of actual TTP to determine the phase-in because both methods yield the same results, as shown in the following example:

- b. Example:

Assume that at POA approval, a tenant's AMI is \$1000 and the tenant is paying \$200 for TTP.

Target TTP: 30 percent of \$1000 = \$300

Current TTP: 20 percent of \$1000 = \$200

Since the \$100 increase is 50 percent of current TTP (greater than a 30 percent increase), it will be phased in over a three-year period.

Amount of annual increase if no other factors change:

$\$100/3 = \33.33 ; or

$10 \text{ percent}/3 = 3.33 \text{ percent of AMI}$

At POA implementation, TTP becomes:

$\$200 + \$33.33 = 233.33$; or

$20 \text{ percent} + 3.33 \text{ percent} = 23.33 \text{ percent}$

At first anniversary, TTP becomes:

$\$233.33 + \$33.33 = \$266.66$; or

$23.33 \text{ percent} + 3.33 \text{ percent} = 26.67 \text{ percent}$

At second anniversary, phase-in is complete and TTP becomes:
 $\$266.66 + \$33.33 = \$300$; or
 $26.67 \text{ percent} + 3.33 \text{ percent} = 30 \text{ percent}$.

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4. Application of Calculated Percentages.
At each anniversary of POA approval and at each recertification of income, the owner must apply the calculated percentages to the tenant's current certified income. If Loan Management Branch has approved a general project rent increase since POA approval, the owner must apply the rent increase factor, as described in Paragraph 5 below, to the calculated TTP.

5. Adjustment by Rent Increase Factor.

A proportionate share of approved general project rent increases may be added to the tenant's TTP during phase-in but not after the phase-in is completed; i.e., until 30 percent of AMI or FMR is reached or the phase-in period ends. This will be accomplished as follows:

- a. PPR is determined for the period beginning at POA approval in accordance with Paragraphs 11-7.A. and B.
- b. General project rent increases will be granted and new PPRs will be calculated in accordance with Paragraphs 11-7.C.1. through 6.
- c. At the time of each general project rent increase during the phase-in period, Loan Management staff must determine a rent increase factor using Form HUD-90010-A, Appendix 11-1A, Section II, and provide it to the owner in the letter approving the rent increase. The owner will apply the factor to each tenant's phased-in TTP calculated in accordance with Paragraph 4. above.

The factor is determined by:

- i. Calculating the PPR after the rent increase as specified in Paragraph b. above.

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- ii. Dividing the latest PPR by the PPR at POA implementation to obtain a rent increase factor. The factor at POA implementation will therefore be 1.0. The reason the factor is determined by using the first PPR after POA implementation rather than the PPR for the previous year is that the factor is applied to a percentage of tenant income which was calculated based on a target rent at POA approval.
- iii. Example: The example used in Paragraph 11-7.C.5. shows an approved operating cost budget for the first year after POA approval of \$300,000, for the second year of \$340,000, and for the third year of \$370,000. We will assume that total approved GRP at POA approval is \$900,000, making GRP for the second year, \$940,000 and for the third year, \$970,000. We will also assume that approved utility allowances for the same three periods were \$50,000, \$55,000, and \$60,000 respectively.

After POA Approval:

Total Project Budget:	\$900,000
Total utility allowances:	50,000
PPR	<u>\$950,000</u>

Rent Increase Factor:
 $\$950,000 / \$950,000 = 1.00$

Second Year:

Total Project Budget:	\$940,000
Total utility allowances:	55,000
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PPR	\$995,000

Rent Increase Factor:
 $\$995,000/\$950,000 = 1.05$

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Phased-in TTPs for the second year will be multiplied by 1.05 to adjust for the rent increase.

Third Year:	
Total Project Budget:	\$ 970,000
Total utility allowances:	60,000
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PPR	\$1,030,000

Rent Increase Factor:
 $\$1,030,000/\$950,000 = 1.08$

Phased-in TTPs for the third year will be multiplied by 1.08 to adjust for the rent increases.

6. Exceptions to the Rules. The method described in Paragraphs 1. through 5. above will determine the tenant's current TTP with the following three exceptions:
 - a. During the phase-in period, TTP is never reduced unless it would exceed either 30 percent of AMI (or Minimum Rent, when applicable, in accordance with Paragraph c. below) or FMR. If the calculated TTP would result in a reduced payment, the previous year's TTP will be used;
 - b. The tenant will not pay more than the lower of 30 percent of AMI (or Minimum Rent in accordance with Paragraph c. below) or FMR even if the TTP calculated for the phase-in exceeds one or both these amounts;
 - c. For moderate-income tenants whose incomes are reduced to below the Section 8 low-income limit, the TTP

will not be reduced to less than the Minimum Rent if Minimum Rent exceeds 30 percent of AMI but does not exceed FMR; and

- d. Tenants who do not receive Section 8 rental assistance will not receive utility reimbursement, no matter how substantially their incomes decrease.

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- E. Inapplicability of Interim Certifications. The TTP will not be changed based on interim certifications, unless it exceeds 30 percent of AMI (or Minimum Rent, when applicable) or FMR without the change.
- F. Rents Phased In Over More than Three Years. At the owner's option, phase-in may take more than three years. The owner may do this by modifying Form HUD-90010, Appendix 11-1, as described in the Instructions to the Form HUD 90010.
- G. All rent increase notification requirements contained in HUD Handbook 4350.3, Occupancy Requirements of Subsidized Multifamily Housing Programs, must be followed.

11-9. Tenant Leases. In a letter to HUD, the owner should propose, and Loan Management staff must review and approve language to be added to all tenant leases to reflect compliance with the requirements of this Chapter. At its discretion, the Chief, Loan Management Branch, may wish to seek the advice and concurrence of the Field Office Counsel regarding the revised lease language. In addition to the provisions of HUD Handbook 4350.3 and the regulations at 24 CFR 247.1, the new lease language must include:

- A. A statement that the tenant will always pay the lower of FMR or 30 percent of AMI for TTP with certain exceptions:
 - 1. A tenant who was classified as moderate-income at the time of POA approval, or upon entering the project, may be required to pay a Minimum Rent if the

tenant's income decreases below the Section 8 low-income limit, the Minimum Rent exceeds 30 percent of the tenant's AMI and Section 8 assistance is not available; or

2. A tenant who receives Section 8 rental assistance and occupies the project after POA approval, will pay rent calculated by the normal Section 8 formula;

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- B. A statement that if the tenant is designated as very low- or low-income at POA approval or upon initially occupying the project, the tenant will always be eligible for Section 8 rental assistance if Section 8 Gross Rent exceeds 30 percent of its AMI and will receive Section 8 assistance when it is available;
- C. A statement that if a moderate-income tenant refuses to certify income, the tenant will be charged the FMR for TTP;
- D. A description of the rent phase-in process;
- E. A statement that security deposits for in-place tenants will not be increased due to POA approval; and
- F. Any other provisions required by Loan Management staff.

11-10. Receipt and Distribution of Project Funds.

- A. Basic Rent, Market Rent, and Excess Income.

1. Basic Rent.

- a. Section 236 Projects. Basic Rents for Section 236 Projects with approved POAs will be set only as a monthly aggregate for the entire project. It is defined as GRP divided by 12. If the project has no utility allowance, so that the GRP equals PPR, the basic rent will also equal PPR divided by 12. The owner must make this calculation whenever a rent increase or utility

allowance is approved.

- b. Below Market Interest Rate Projects. While BMIR projects have no basic rents, the owner will calculate the monthly aggregate rent for the entire BMIR project using the method to determine Basic Rent in Paragraph a. above in order to determine the amount of excess income.

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2. Market Rent and its calculation is only relevant to Section 236 projects. It will equal the project's specific annual subsidy amount (interest reduction payment), divided by 12, added to the basic rent.
 3. Excess Income. In any month, any rents collected, which exceed the monthly aggregate amount calculated in Paragraph 1. above, will be considered excess income.
 - a. Section 236 Projects. Excess income must be remitted to HUD, up to an amount equal to the project's specific annual subsidy amount divided by 12. The remainder must be deposited to the project's residual receipts account.
 - b. BMIR Projects. All excess income must be deposited to the project's residual receipts account.
- B. Residual Receipts and Reserve for Replacement Accounts will be treated by the owner and monitored by the Loan Management staff in the same manner as discussed in HUD Handbook 4350.1.
 - C. Owner's Distribution. The owner may have periodic access to the residual receipts or reserve for replacement accounts to the extent specified in Paragraphs 1. through 3. below provided the Loan Management staff determines that the levels of the accounts are adequate, that the project is maintained in accordance

with the Housing Quality Standards (HQS), and the owner is complying with the Use and Amended Regulatory Agreements, in accordance with Paragraph 11-13.

1. An owner who retained ownership of the project may take an approved distribution from surplus cash not to exceed eight percent of the extension preservation equity as established by the appraisal process. The distribution is reduced by

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the debt service applied to any equity loan that the owner receives. It should be noted that some owners may have agreed to accept a smaller, or no, return in order to keep PPR below the FCL.

2. A for-profit purchaser may receive an approved eight percent return on any actual HUD-approved cash investment made to purchase or rehabilitate the project unless it agreed to accept a smaller, or no return in order to keep the PPR below the FCL.
 3. A priority purchaser may receive an approved eight percent return on any HUD approved cash investment made to purchase the project. This return may only be withdrawn to pay for activities authorized by the nonprofit organization's charter, or to pay debt service on a non-insured loan to acquire the project.
- D. Exceptions During Phase-In Period. During the phase-in period, tenant rents may not provide adequate income to pay the approved owner's distribution. If this occurs, the following procedures apply:
1. Owners who Retain the Project. An owner who retains the project will be ensured receipt of the annual authorized return (AAR) during the phase-in period, even if insufficient income is generated from tenants' rents that are being phased in. However, the owner is not ensured the AAR

if: (1) insufficient income is due to excess project vacancies, or (2) the AAR is greater than the amount the owner agreed to accept at POA approval in order to keep PPR below the FCL. During the phase-in period only, AAR will be ensured in the following manner:

a. Section 236 Projects.

- i. During the first year after POA approval, excess income in any month must be remitted to HUD.

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Any unspent proceeds will be deposited to the residual receipts account.

- ii. At the end of the first year, the owner may have access to the residual receipts account up to the amount of the approved AAR. If there are insufficient funds to pay the AAR, the owner must show, through an audit, how much of the shortfall was caused by the tenant phase-in.
- iii. During the second year after POA approval, the owner may retain the excess income up to the amount of the shortfall due to the rent phase-in, determined in accordance with Paragraph ii. above. If this amount is sufficient over the year to pay the shortfall, the same process will continue through the third and fourth years. If excess income is insufficient to pay the shortfall, the amount due the owner will be temporarily added to the project's approved rent during the third and fourth year after POA approval. Form HUD-90011 provides a method for calculating this temporary

increase. The owner will then retain excess income each month until past years' shortfalls are recovered.

b. BMIR Projects.

- i. During the first year after POA approval, any unspent proceeds will be deposited to the residual receipts account. At the end of the first year, the owner may have access to the residual receipts account up to

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the amount of the approved AAR. If there are insufficient funds to pay the AAR, the owner must show, through an audit, how much of the shortfall was caused by the tenant rent phase-in.

- ii. During the second and subsequent years, up to the end of the rent phase-in period, a temporary rent increase may be granted to pay the portion of the AAR shortfall caused by the rent phase-in. The owner may retain excess income, up to the amount of the shortfall in previous years. Form HUD-90111 provides a method for calculating this temporary increase.
2. Purchasers. Purchasers may not receive the full owner's distribution if there are not adequate funds in the residual receipts account to pay for it. This shortfall may not be compensated by means of a temporary or permanent rent increase. Loan Management staff should be cautious in reviewing utility allowances during the phase-in period, since an underestimate for utility allowances will generate a higher rent, given the same TTP.

- 11-11. Non-Renewal of Section 8 LMSA Contract and Permissible Prepayment. If HUD is unable to renew a Section 8 LMSA contract because of the lack of funding, the owner may request a modification of the low-income Use Agreement on the mortgage.
- A. Loan Management staff must notify the owner at least 30 days prior to the expiration date of the Section 8 HAP contract if funds will not be available to renew the contract and will continue to be unavailable so that HUD will not be able to fund the contract retroactively. LOG date owner notified

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- B. Within 30 days of receipt of the notice that HUD is unable to fulfill the terms of the original POA, the owner must inform the Loan Management Branch that it is requesting a modification of the low-income Use Agreement. The owner must request that HUD take action to amend the terms of the contract or that it be allowed to prepay the mortgage. LOG notification from owner received
- C. Within 30 days of receipt of the request from the owner to prepay the mortgage in accordance with Paragraph B. above, HUD must make a determination of whether the project is located in a low-vacancy area, in accordance with Paragraph 11-12, and return such information to the owner. LOG date returned
- D. Not later than 90 days from receiving the owner's request, Loan Management staff must take action to amend the terms of the POA so that the owner will receive comparable benefits. LOG action taken If, within the 90 days, Section 8 LMSA funds become available, HUD will renew the Section 8 HAP contract retroactively.
- E. If Loan Management staff cannot extend or amend the Section 8 HAP contract or give comparable benefits, then the owner may terminate the low-income affordability restrictions in accordance with Paragraph 8-31.B. The owner must provide protection to all project tenants pursuant to the

requirements cited in Paragraphs 10-3 through 10-6.

- 11-12. Designation of a Low-Vacancy Area. Within five days of receipt of an owner's request to prepay, in accordance with Paragraphs 7-14, 7-15, 8-31 or 11-11, the Loan Management staff must request EMAS LOG date request made to determine whether the project is located in a low vacancy area as defined in Paragraph 1-15. EMAS must notify the Loan Management Branch of its determination within 15 days. LOG date notification received Within 30 days of receipt of the owner's request, the Loan Management staff must advise the owner if the area has been designated low-vacancy. If the area is

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designated low-vacancy, the Loan Management staff must further advise the owner of the additional protection it must give potentially displaced tenants in accordance with Paragraph 10-4.

- 11-13. Violations of the Housing Quality Standards (HQS) or Use Agreement and Amended Regulatory Agreement. As a condition for receiving incentives, the owner must sign a Use Agreement that specifies occupancy standards and that sets TTP and tenant rent levels, and an Amended Regulatory Agreement that specifies other conditions described in this Handbook. The owner must also have agreed to maintain the project in accordance with local housing codes and HQS. Where the HQS differs from local housing codes, the owner must maintain the project in compliance with the stricter standard.
- A. Monitoring Compliance.
1. Physical Assessment of the Project. Loan Management staff must conduct an annual physical assessment LOG date each assessment of the project to determine compliance with the HQS using Form HUD-9822, Physical Inspection Report. The assessment will be conducted in two parts:
 - a. Physical Inspection.
 - i. At least 30 days prior to the inspection, Loan Management

staff must notify the tenant representatives, if any, and the project owner or manager of the date and time it will conduct the inspection. LOG date notified If they choose, the tenant representatives may accompany the inspectors.

- ii. Tenant representatives are responsible for getting comments from other tenants about the project's physical condition and presenting them to HUD. If there is no tenant representative, Loan Management

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staff will provide the owner with a notice that must be posted in each affected building, stating the time and date of the inspection and exit conference and advising any interested tenants that they may attend the exit conference and/or submit any comments to HUD that they may have about the project's physical condition.

- b. Exit Conference. Immediately following the physical inspection, Loan Management staff must hold an exit conference with management and tenant representatives to discuss the findings of the inspection.
- 2. Monitoring Compliance with Agreements. As part of normal project monitoring activities, Loan Management staff must monitor compliance with the Use and Amended Regulatory Agreements. If a tenant or tenant representative reports a violation, Loan Management staff must investigate within 30 days.
 - 3. Correcting Deficiencies.
 - a. Within 30 days after the inspection

or determination of a violation of any Agreements, Loan Management staff must notify the owner of the findings. LOG date owner notified

- b. Within 90 days of receipt of notification of the findings, the owner must correct any deficiencies in order to resolve the findings.
LOG date deficiency corrected
This action would include rebating excess rent paid by the tenants or paying relocation expenses for tenants who were accepted for occupancy inappropriately.

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- c. Upon notification by the owner that the deficiencies have been corrected, Loan Management staff will reinspect the project or investigate to confirm that the violation has been corrected. LOG date of reinspection or investigation If there are any outstanding findings or deficiencies remaining, the owner forfeits the annual authorized distributions and HUD may take additional actions to bring the owner into compliance with the program regulations.

- B. Sanctions for Noncompliance. If Loan Management staff determine that an owner has continued its noncompliance with the Agreements, including those to maintain the project in accordance with HQS, Loan Management staff may recommend sanctions to the Field Office Counsel to bring the project into compliance. The Field Office Counsel must approve these sanctions prior to implementation of them by the Loan Management staff. Sanctions may include:
 - 1. Directing the mortgagee to withhold the disbursement to the owner of any escrowed equity take-out loan proceeds, and if the project is not in compliance with HQS, requiring that such proceeds be used for repair of the project;

2. In the case of a violation of the HQS, reducing allowable distributions to four percent of the extension preservation equity or (in the case of a purchaser) four percent of the cash investment, as appropriate, for a period ending upon a determination by HUD that the project is in compliance with HQS. Any amount withheld may not be withdrawn until the repairs are made, and at that time may only be withdrawn to pay for the repairs; and
3. In the case of violations of other Agreements, withholding the allowable distributions for a period ending upon a

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determination by HUD that the project is no longer in violation of the Agreements. Amounts withheld may be used to rectify violations of the Agreements.

4. Fair Housing Monitoring. Loan Management staff must refer any possible violations of the civil rights provisions of any agreement to the FHEO Program Operations Division in the Regional Office or the FHEO Division in the Field Office. If the information includes a formal complaint of discrimination under the Fair Housing Act or other Civil Rights Statute, the complaint must be referred to the Regional FHEO Compliance Division for further investigation.
- C. Monitoring After Compliance. To ensure continued compliance with the HQS and other Agreements for a project subject to the sanctions under Paragraph B. above, HUD may limit access to and use by the owner of the amounts identified in Section B above for not more than a two year period. This period will begin upon a determination made by the Loan Management staff that the project has been brought back into and remains in compliance with the HQS and Agreements.
- D. Sanctions for Continuous Noncompliance. If

Loan Management staff determine, upon inspection or investigation, that the owner has failed to comply with the HQS or other Agreements for two consecutive years, they may, upon notification to the owner of the noncompliance, take one or more of the following actions:

1. Subject to the availability of appropriations, provide assistance in the form of Section 8 vouchers or certificates for any tenant eligible for such assistance who desires to terminate occupancy in the project. For each Section 8 voucher or certificate provided, the Loan Management Branch may, notwithstanding any other law or contract for rental assistance, reduce the provision of Section 8 project-based

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assistance by one unit, in accordance with HUD Handbook 4350.2, Section 8 Loan Management Set Aside, Appendix 6. Reduction of the Section 8 assistance does not release the owner from the obligation to rent to tenants in the proportions shown on the tenant profile in accordance with Paragraph 8-17.F. or permit the owner to charge very low- or low-income tenants more than they would have paid under the Section 8 TTP formula.

2. Direct the mortgagee to declare all equity and rehabilitation loans to be in default and accelerate the maturity dates of the loans. In the case of loans provided by HUD, including Flexible Subsidy loans, declare, them to be in default and accelerate the maturity date of the loans; and
3. Suspend payments under, or terminate any contract for Section 8 project-based rental assistance. Taking such action does not constitute abrogation of the Use Agreement on HUD's part and therefore, does not allow the owner to prepay.

E. Other Sanctions. HUD may take any other action, authorized by the law or the project's Amended Regulatory Agreement or Use Agreement, to ensure that the project is brought into compliance with all Agreements and with HQS or with other requirements pertaining to the condition of the project.

11-14. Sale by a Priority Purchaser to a Non-Priority Purchaser. In the case of a voluntary sale, if a priority purchaser becomes affiliated with or transfers the project to a non-priority purchaser within ten years of approval of a POA, HUD may seek reimbursement of assistance from the priority purchaser. This reimbursement will be in the amount that represents the difference between the assistance actually provided and the amount the non-priority purchaser would have received.

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11-15. Partially Assisted Projects. In several states, there are Section 236, State Agency, non-insured projects with blended rate mortgages where only a portion of the units are subsidized. In these projects, rents for the proportion of the project which is subsidized may not be used to help pay any expenses for the unsubsidized portion of the project.

A. In partially assisted projects, Loan Management staff and the owner must be certain that only an appropriate portion of the project budget is allocated to subsidized units. Loan Management staff must closely examine the project's PPR at POA approval and at the time of any rent increase in which the PPR determined by the OCAF is appealed to ensure that only expenses attributable to the subsidized portion are allowed.

B. Unless otherwise specified in approved documents, the ratio of subsidized units of each size and type must be the same as the ratio of subsidized units in the entire project.

C. The owner may use a variety of methods to present the budget, including separating the subsidized and unsubsidized portions of the budget into two budgets or proportionately

allocating a single budget between subsidized and unsubsidized units. Loan Management staff must be certain that proper allocation of expenses has taken place.

- D. The projected rent for moderate-income tenants in the subsidized portion of the project must be subtracted from the PPR allocated to the subsidized portion. Section 8 Gross Rents will be used to make up the difference for that portion of the project only. In no case may Section 8 rents be used to subsidize shortfalls in rents in the unsubsidized portion of the project.
- E. Loan Management staff should contact the Preservation Division with questions concerning review of budgets in unique circumstances.

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11-16. Projects with Commercial Space. In projects where there is commercial space, rents for the subsidized units may not be used to pay any expenses for the commercial space.

- A. The Loan Management staff and the owner must be certain that only the appropriate portion of the project budget is allocated to rental units. The Loan Management staff must closely examine the project's PPR at POA approval and at the time of any rent increase in which the PPR determined by the OCAF is appealed to ensure that only expenses attributable to the subsidized rental units are allowed.
- B. The owner must separate any income and expenses for the commercial space. The Loan Management staff must be certain that proper allocation of expenses has taken place. It may be necessary for some expenses (e.g., administrative and utilities) to be allocated proportionately.
- C. In no case may tenant-paid rents or HUD-paid Section 8 rents be used to subsidize shortfalls in commercial income to cover the costs of operating the commercial space.
- D. Loan Management staff should contact the

Preservation Division with questions
concerning review of budgets in unique
circumstances.

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