

CHAPTER 7: RENTS AND CHARGES

Section 1. Introduction

7-1. CHAPTER OVERVIEW. The coinsurance regulations and the regulatory agreement provide that project owners may collect rents and charges for facilities and services only in amounts permitted under HUD's administrative requirements. HUD's requirements are designed to carry out the statutory mandate to provide reasonable rents to project residents and a reasonable return on the owner's investment. Section 1 of this Chapter summarizes HUD's limitations on project rents and charges for facilities and services; Section 2 provides owners with guidance on how to request rent increases; and Section 3 instructs lender's on how to process those requests. Finally, Section 4 sets forth procedures for owners and lenders to use in requesting HUD's preemption of local rent controls.

7-2. APPLICABILITY OF CHAPTER.

- a. This Chapter applies only to unsubsidized units or units participating in the Section 8 Loan Management Set-Aside (LMSA) Program. If a project is participating in another HUD subsidy program (e.g., Section 8 New Construction), the owner must determine rents and other charges in accordance with the HUD regulations and administrative procedures that apply to that subsidy program.
- b. This Chapter's procedures and requirements apply as long as the coinsurance contract remains in force. This chapter does not apply to the period during which the lender owns the project. Chapter 10 sets forth HUD's requirements for determining rents and charges between the date the lender acquires title to the property and the earlier of the date the lender sells the property or files a claim for insurance benefits.

Section 2. Limitations on Rents and Charges

7-3. COMMERCIAL FACILITIES. Generally, during the first year of occupancy owners must rent commercial space at rates at least equal to the rates specified on the Form HUD-92264, Project Income Analysis and Appraisal, approved at firm commitment. Form HUD-92264's minimum rents are set at the level needed to cover the commercial space's share of the debt service and operating expenses that must be paid by the project. Owners must periodically adjust commercial rents as needed to cover any increases in operating expenses that are associated with the commercial space and paid by the project. If the owner offers commercial leases for periods in excess of one year, the leases should provide for these periodic rent adjustments. Lenders may permit owners to charge less than the minimum rents required by this paragraph only if the lender determines that: (1) the owner has taken all reasonable steps to lease the space at the minimum rents; and (2) approval of reduced rents will not jeopardize the financial condition of the project. The lender must

thoroughly document the reasoning underlying its decision to approve reduced commercial rents. The owner may charge commercial rents in excess of the minimum amounts discussed above; no lender approval is required. All income derived from commercial space must be deposited in the project's operating account.

- 7-4. CHARGES FOR SERVICES AND FACILITIES. Owners may not charge tenants for services or equipment that are included in the rent. The Form HUD-92264 and Page 1 of the Form HUD-92458, Rent Schedule (Appendix 22), identify what those services are. Owners may charge residents for other facilities or services provided by the project (e.g., parking, cable TV, etc.) only: (1) if use of those services or facilities is voluntary on the part of the residents; and (2) the services, facilities and charges have been included on the Rent Schedule most recently approved by the lender. All income derived from such charges must be deposited in the project's operating account.
- 7-5. APARTMENT RENTS. When an owner requests an increase in apartment rental rates, the maximum allowable residential rent must be determined using either the cost approach discussed in paragraph 7-5.a. or the market approach discussed in paragraph 7-5.b. If the project is receiving Section 8 Loan Management Assistance or if the owner is seeking HUD preemption of local rent control, the owner and the lender must use the cost approach. For all other projects, owners may choose which formula will be used.
- a. Cost Approach. Under this method, the maximum allowable rent potential is computed using the sum of projected operating expenses and the dollar amount that was allowed for debt service and owner return during the processing of the project's application for coinsurance. Because that allowance is based upon the appraised value recognized at endorsement, the allowance for owner return remains constant from year to year.
- b. Market Approach. Under this method, the maximum allowable rent potential is the lesser of:
- (1) the potential that would result if the owner charged the "market rents", as defined in Paragraph 7-6.; or
 - (2) the potential computed using the sum of projected operating expenses and a debt service and return to owner allowance that is based upon the project's current appraised value as rental housing. Because the appraised value can change over time, the allowance for owner return can vary from year to year.
- 7-6. MARKET RENTS. These are the rents a market analyst (i.e., an appraiser or other person who meets the criteria in

paragraph 7-10.b.) estimates the owner could obtain, given the rental market in which the project is located. In computing market rents, the market analyst: (1) selects projects which are comparable to the project requesting the increase;

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(2) determines what rents those projects are charging; and (3) adjusts those amounts to reflect differences between the subject coinsured project and the projects selected as comparables.

- a. To prepare the market rent analysis, the market analyst must use Form HUD-92273, Estimate of Market Rents by Comparison, or a similar form, which is acceptable to the lender and provides the required information and analysis. Form HUD-92273 is shown in Appendix 25. The analyst must prepare a separate form for each unit type (e.g, two-bedroom, one bath; two-bedroom, 1 1/2 bath; three bedroom with den; three bedroom without den).
- b. In computing market rents, the market analyst must use at least three projects. The projects must be conventionally-financed, not subject to any form of HUD rent regulation, and comparable to the coinsured project requesting the rental increase. Projects should be considered comparable if they have approximately the same number of units, are located in areas affected by similar cost and market considerations, and are of similar age and design.
- c. The market analyst must adjust the rents of comparable projects to those of the subject project. The analyst must adjust for differences in apartment sizes, equipment, services, amenities, location and age/physical condition. For example, if drapes are included in the rent for the subject project but are not included in the comparable project and the appraiser determines that the value of this amenity is \$5 per month, the analyst must add \$5 to the rent of the comparable project.

7-7 RENT COMPUTATION WORKSHEET. Owners and lenders must use the Worksheet (Form HUD-92547A) shown in Appendix 23 to compute and document both the cost and market approach. Part I of this Worksheet itemizes operating expenses actually incurred and the owner's and lender's estimates of expenses expected to be incurred during the 12-month period following the date the rent increase will be effective. Part II of the Worksheet computes the maximum rent potential allowed under either the cost approach or the budget half of the market approach. Part III computes the rent potential using market rents. In Part IV, the owner certifies that all the information on the Worksheet is true and accurate. Part V documents the rent potential approved by the lender. Appendix 23 provides more detailed instructions for preparing this Worksheet.

7-8 RENT SCHEDULE. The project owner may implement increases in apartment rents only after submitting a Rent Schedule (Form HUD 92458) to the lender and obtaining the lender's signature on that schedule. Appendix 22 presents a copy of the Rent Schedule and instructions for preparing it. If the potential proposed by the owner is more than the Maximum Allowable Monthly Potential approved in the original rent formula or on Line C of Part V of the most recent Rent Computation Worksheet, the lender may sign the Rent Schedule only after the owner and lender have complied with the procedures set forth in this Chapter. If the proposed potential is less than or equal to the Maximum Allowable Rent Potential

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already approved by the lender, the lender must review, sign and return the Schedule to the owner within 7 days of receipt.

Section 3. Owner Submission Requirements

7-9. COST METHOD. If the owner elects to use the cost method discussed in Paragraph 7-5.a., the owner must submit the following materials:

- a. A cover letter that
 - (1) reports on project occupancy - e.g., number of units vacant; size of waiting list; any problems leasing particular unit sizes; and the cause of any vacancy rate in excess of 5%.
 - (2) describes the project's current physical conditions and any improvements for which the owner budgeted funds on Line I of Part I of the Worksheet.
 - (3) sets forth the unit rent and monthly rent potential the owner wishes to charge for each type of unit.
(NOTE: The lender will enter the rents on the Rent Schedule after the lender has reviewed the owner's computations on the Rent Computation Worksheet.)
- b. A Rent Computation Worksheet (Form HUD-92547A).
Generally, the owner must use the Worksheet shown in Appendix 23. The lender may authorize an owner to modify the order and or composition of the expense lined shown on the face of the Worksheet so long as: (1) expenses are still grouped into the categories used in Part I of the Worksheet; and (2) the owner clearly identifies which accounts are included on each line.
- c. A brief statement explaining the basis for each expense estimate. Appendix 24a provides a sample of such a statement.
- d. If not already on file with the lender, an audited

Statement of Profit and Loss (Form HUB-92410) prepared in accordance with HUD Handbook 4370.2 and covering the project's most recently ended fiscal year.

- e. Rent Schedule (Form HUD-92458). Owners must complete the first two columns of Part A and all of Parts B through E and Parts G and H. The lender will complete Columns 3 and 4 of Part A, Part F and Part H after reviewing the owner's Rent Computation Work-sheet.

7-10. MARKET METHOD. If the owner elects to use the market method, the owner must submit the following materials:

- a. All items listed under Paragraph 7-9.

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- b. A Market Rent Analysis. This analysis must be prepared by a qualified appraiser, a CPA who is experienced in conducting such analyses, or an individual who has been certified by a national housing management organization and was trained, as part of the certification program, to conduct market rent analyses. The market analysis must be prepared in accordance with the guidelines set forth in Paragraph 7-6.
 - c. An appraisal of the project's value as rental housing. The appraisal must be prepared by a qualified appraiser. The appraiser must use the market approach to determine value and then allocate the total value between the residential and commercial space. NOTE: Since the market approach sets rents at the lesser of the two computations discussed in Paragraph 7-5.b., it is not necessary to submit a new appraisal with each rental increase request. An updated appraisal is needed only when the rents the owner wishes to charge are greater than the rents derived by using the most recently submitted appraisal and the formula discussed in Paragraph 7-5.b.(2).

Section 4. Lender's Review of Owner Requests

7-11. THIRTY DAY PROCESSING. Within 30 days after receiving a complete rental increase request from the owner, the lender must render a written decision on the owner's request. If the lender does not render a written decision within those 30 days, the owner may implement the rents but must place the additional rents in an escrow account or provide the lender with a letter of credit equal to the additional rent the lender estimates the project will collect between the date the requested increase is implemented and the date the lender's final decision is expected. If the lender later disapproves the rent increase or approves the increase for less than the amount requested, the owner must immediately refund any amounts collected in excess of the rents the lender authorized.

7-12. LENDER'S REVIEW OF THE OWNER'S SUBMISSION. The lender should use the following steps to review and process owner requests for increases in maximum potential rent.

- a. Check for Completeness. If the request package is incomplete, the lender must require the owner to submit the missing information. Paragraph 7-11's thirty day period begins only after lender has received a complete package.
- b. Review Related File Documents. The lender must familiarize itself with the project's conditions, income and operating expenses. To do so, the lender should review the project's previous rent computations, annual and any monthly financial statements, physical inspection and management review reports, energy audits, etc.
- c. Check Equipment and Services Provided. The lender must review the proposed rent schedule to determine if any changes in equipment or services are proposed. If changes are proposed, the lender

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- must consider how those changes will affect the project's future income and expenses.
- d. Review the Operating Expenses Projected by Owner. The lender must evaluate whether the owner's estimate of future operating expenses is reasonable given project conditions and the cost area in which the project is located. The lender should consider expense trends as well as absolute dollar amounts. In assessing reasonableness, the lender should compare the subject project's past and projected expenses with those of comparable projects. The per-unit-per-month figures in Part I of the Rent Computation Worksheet provide a good basis for comparing categories of expenses. Additional guidance on assessing reasonableness is provided in Appendix 24b and in Paragraph 2-23 of HUD Handbook 4370.1 REV-1, Reviewing Annual and Monthly Financial Reports.
 - e. Review Owner's Estimates of Service Income. Line I.4. in Part II of the Rent Computation Worksheet should include all income likely to be collected on laundry, parking and other auxiliary services. Since the worksheet is designed to compute only the income required to cover expenses associated with the residential portion of the project, income from commercial space should not be considered anywhere on the Rental Computation Worksheet. The lender should compare estimated service income with prior periods collections and consider whether there have been any changes in services provided or charges imposed for those services.
 - f. Review Owner's Estimate of Vacancy Losses. The occupancy

percentage on Line K.1. of Part II of the Worksheet must be the lender's and owner's best estimate of the occupancy rate the project will likely experience during the year following the rental increase, but never less than 92% nor more than 98%. To evaluate the accuracy of the owner's estimate, the lender should consider both the project's and the market area's recent occupancy rates. The lender must also consider whether those rates are likely to change in the near future because of the owner's efforts (e.g., increased marketing) or changes occurring in the market (e.g., new businesses moving into the area).

- g. Review Appraisal and Market Rent Analysis. If the owner used the market method to compute the proposed rents, the lender should determine whether:
 - (1) the appraisal meets the criteria discussed in Paragraph 7-10.c.;
 - (2) the market rent analysis meets the criteria discussed in Paragraphs 7-6 and 7-10.b.;
 - (3) the projects selected as comparables and the adjustments made to the comparable projects' rents are appropriate.

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- h. Check Owner's Arithmetic. The lender must double-check all math computations and compute the allowable rent potential using any revised figures required by these review steps.
 - i. Document Allowable Rent Potential. The lender must enter the Maximum Allowable Monthly Rent Potential on Line C of Part V of the Rent Computation Worksheet and sign and date the Worksheet in Part VI. In addition, if the lender revised any of the owner's income or expense estimates, the lender must document why the owner's estimates were unacceptable. If the rent potential listed in the owner's rent increase request is
 - (1) less than or equal to the potential approved by the lender, the lender must enter the owner's proposed rents and rent potential in Columns 3 and 4 of the Rent Schedule.
 - (2) higher than the potential approved by the lender, the lender must call the owner and ask the owner how he/she wishes to spread the approved potential. The lender must enter those revised rents in Columns 3 and 4 of the Rent Schedule.

7-13. LENDER'S NOTICE TO THE PROJECT OWNER AND HUD.

- a. The lender must advise the owner in writing of the results

of its review. If the lender does not approve the rents proposed by the owner, the lender's decision letter must explain why all or part of the increase was denied. The lender should send the letter and Rent Schedule to both the owner and the management agent. The lender and owner must maintain copies of all correspondence and documents related to rental increases for three years.

- b. The lender must send the HUD Field Office one copy of each approved Rent Schedule and one copy of each decision letter that approves less than the monthly rent potential the owner requested.

Section 5: Preemption of Local Rent Control

- 7-14. INTRODUCTION. If an owner determines that rent levels permitted by a local rent control Board are not sufficient to operate the project, the owner may request HUD to preempt the local Board. HUD will preempt the rent control board if HUD determines that the Board's delay or decision will prevent the owner from obtaining the income needed to operate the project. All requests for HUD preemption of the local Board's rent controls must be processed in accordance with the procedures discussed in this Section. These procedures are summarized in Exhibit 7-1.
- 7-15. ACTIONS OWNER MUST TAKE BEFORE SUBMITTING A FORMAL REQUEST FOR PREEMPTION. If an owner decides to pursue HUD's preemption, the owner must first ask the local rent control Board for whatever relief or redetermination is permitted under State or local law. The owner's request must advise the Board of the owner's intent to request HUD-preemption, if necessary.

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When filing the request for relief, the owner must notify the project residents and the lender that it intends to request HUD's preemption if the board does not respond to the request within 30 days or renders a decision which is unacceptable to the owner.

- a. Notice to Residents. The owner's Notice must contain all the information contained in the Notice shown in Appendix 26. The owner must: (1) hand deliver or mail a copy of the notice to each resident; and (2) post the Notice in at least three conspicuous places within each building in which the affected dwelling units are located. The owner must comply with all representations made in the Notice to Residents, including giving residents 30 days to review materials that will be submitted to justify the preemption request. The owner may post the Notice as soon as it has submitted a request for relief or redetermination to the Board.
- b. Notice to the Lender. Immediately after distributing and

posting the Notice to Residents, the owner must advise the lender that it intends to request HUD's preemption of the Board's actions. To do so, the owner must provide the lender with three copies of all of the materials listed below.

- (1) A copy of the Notice to Residents, annotated to show the date(s) the Notice was posted and distributed.
- (2) Rent Computation Worksheet (Appendix 23). The owner must use the cost approach to compute the allowable rent potential. In computing the allowance for owner return and debt service, the owner must delete the 0.5% override normally allowed on Line F.1. in Part II of the Worksheet.
- (3) An audited Statement of Profit and Loss (Form HUD - 92410) prepared in accordance with HUD Handbook 4370.2 and covering the project's most recently ended fiscal year. If more than four months have elapsed since the end of the project's fiscal year, the owner must also submit, and certify to the accuracy of, an unaudited Form HUD-92410 for the period elapsed since the end of the project's last fiscal year.
- (4) A copy of the relief application the owner submitted to the Board pursuant to Paragraph 7-15.
- (5) Itemization of resident turnover rates and percentages of rent potential lost to vacancies and to nonpayment of rent on occupied units during the period covered by the Forms HUD-92410 required by Paragraph 7-15.b.(3) above and by the fiscal year preceding those periods. Each type of loss and each fiscal period must be reported separately. The following format is suggested:

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	Since end of Last FY	FY ending _/_/_	FY ending _/_/_
Number of units vacated	_____	_____	_____
Percentage of Rent Potential lost to:			
a) Vacancies	_____ %	_____ %	_____ %
b) Collection Loss	_____ %	_____ %	_____ %

- (6) Owner's statement as to whether the following expenses increased or decreased during the 12 months preceding the date of the owner's Notice to Residents. If such changes did occur, the owner must give the date the changes were or will

become effective and the old and new rates.

- (a) Property tax assessment or valuation rates
- (b) Utility rates
- (c) Employee salaries or benefits
- (d) Insurance

7-16. INITIAL LENDER REVIEW FOR COMPLETENESS. Immediately upon receipt of the owner's submission, the lender must check the package for completeness. If the submission does not contain all of the information required by Paragraph 7-15.b., within 48 hours of receipt the lender must request the missing information from the owner. The lender must hold the submission in abeyance until the owner submits a formal preemption request in accordance with Paragraph 7-15.b. If the materials omitted from the initial submission were not previously made available to the project residents, the owner must give residents 30 days to review these materials.

7-17. OWNER'S FORMAL PREEMPTION REQUEST. After the resident comment period has expired and the owner has evaluated any resident comments received, the owner may submit a formal request for HUD preemption. The owner should send the request to the lender and should include three copies of all of the materials listed below.

- a. Copies of all of the written comments the residents submitted to the owner;
- b. The owner's evaluation of the residents comments;
- c. The Board's decision or a statement from the owner certifying that a decision from the Board has not been received;

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d. The owner's certification that:

- (1) the Notice to Residents required by Paragraph 7-15.a. was given in accordance with the provisions of that paragraph;
- (2) the owner has taken reasonable steps to assure that:
 - (a) the substance of the Notice has been conveyed to each resident household; and
 - (b) the posted notices were maintained intact and in legible form for the full resident comment period;
- (3) copies of the materials submitted in support of the preemption request were located in a place reasonably convenient to residents during normal business hours and at least one evening a week after business hours;
- (4) requests by residents to inspect such materials, as provided for in the Notice, were honored; and

- (5) copies of all comments received from the residents were considered and are being transmitted to the lender;
 - e. A cover letter which is signed by the owner and includes a statement that "under the penalties and provisions of Title 18 USC 1001, the statements contained in this application and its attachments have been examined by me and, to the best of my knowledge and belief, are true, correct and complete."
- 7-18. LENDER PROCESSING OF PREEMPTION REQUEST. The lender must determine if the owner's package includes all of the information required by paragraph 7-14.b. and must request any missing materials from the owner. The lender must carefully review any resident comments, the owner's analysis of those comments and any Board decision already received. After reviewing those materials, the lender must determine what rental potential is warranted.
- a. To do so, the lender must review the owner's Rent Computation Worksheet. The lender must determine whether the owner has used the cost approach and deleted the 0.5% override normally allowed for owner return and debt service on Line B.7. in Part II of the Worksheet. The lender must check all of the owner's calculations and adjust the computations, as necessary.
 - b. Once the lender has computed the Maximum Allowable Rent Potential, the lender must provide the HUD Field Office with two copies of its analysis, the owner's submission, and the lender's recommendations as to whether HUD should preempt.

NOTE: If the owner receives the Board's decision after filing its preemption request with the lender, the owner must immediately notify the lender that a decision has been received and must give the lender a copy of the Board's decision.

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- 7-19. HUD PROCESSING OF PREEMPTION REQUEST. Within 10 days of receipt of the lender's submission, the HUD Field Office must review the lender's and owner's analysis and any resident comments and determine what rent levels are necessary to operate the project.
- a. If the rent levels computed by the Field Office are greater than those permitted by the local Board or if the local Board has not yet rendered a decision on the owner's request for relief, the Field Office must discuss the project's needs with the Rent Control Board. If the Field Office and Board are able to reach agreement on a rent level, the Field Office should confirm the agreement

in writing and provide the lender, the Board and the owner a copy of the agreement. If the Board and the Field Office cannot reach agreement on a rent level, the Field Office must forward the case to the Office of Multifamily Housing Management in Headquarters. The Field Office must clearly explain both its own and the Board's positions and recommend what action Headquarters should take. The Office of Multifamily Housing Management will review the case and issue a decision establishing the maximum rent level the owner may charge. HUD Headquarters will send copies of its decision to all parties -- the HUD Field Office, the lender, the owner and the Board.

- b. If the rent potential computed by the Field Office is less than the potential authorized by the Board, the Field Office should deny the owner's request for preemption. The Field Office must give the owner and the lender a letter specifying the maximum monthly rent potential the Field Office will approve. The Field Office must send a copy of the letter to the Board and to the Office of Multifamily Housing Management in Headquarters.

7-20. OWNER IMPLEMENTATION OF HUD'S DECISION ON PREEMPTION. The owner must notify residents of HUD's final decision on the preemption request. The owner's notice must be: (a) hand delivered or mailed to each resident; and (b) posted in at least three conspicuous places within each structure in which the affected units are located. The owner's notice must convey HUD's reasons for approval or disapproval of the preemption request. The owner may implement the HUD approved rent levels only after giving the project residents at least 30 days written notice of the increase and complying with any other applicable terms of the tenants' leases.

7-21. PREEMPTION OF RENT CONTROL BOARD'S LEASE REQUIREMENTS. Some rent control Boards specify minimum lease terms which are in excess of one year. If HUD decides to preempt the Board's rent controls and it will take the project more than 60 days to reach the rent levels authorized by HUD, HUD will preempt the local Board's requirements on minimum lease terms. Until the project is charging the HUD approved rent potential, the owner may not offer residents leases with terms in excess of one year.

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EXHIBIT 7-1.

OVERVIEW OF THE PREEMPTION PROCESS

1. Owner requests Board to authorize any relief available through State or local law.
2. Simultaneously with Step #1, owner notifies the project residents and the lender of its intent to request HUD's

- preemption and submits preliminary package to the lender.
3. Residents have 30 days to review documentation owner intends to submit in support of preemption request.
 4. Owner submits formal preemption request to the lender.
 5. Lender processes owner's request and submits recommendation to HUD Field Office.
 6. HUD Field Office reviews the case file and determines what rent level is needed to operate the project. Field Office and Board reach agreement on rent level or Field Office recommends that HUD Headquarters preempt the local rent control board.
 7. Headquarters reviews case and issues final decision. Headquarter's decision letter is addressed to the owner; Field Office, lender, and Rent Control Board receive copies.
 8. Owner notifies residents of HUD's decision and implements rent levels authorized.