
CHAPTER 34: CALCULATING RENTS UTILIZING ANNUAL ADJUSTMENT FACTORS**SECTION 1: ANNUAL ADJUSTMENT FACTOR (AAF) RENTS (RESERVED)****SECTION 2: SPECIAL RENT INCREASES FOR PROPERTY DISPOSITION PROPERTIES SOLD ON AN ALL CASE BASIS**

- 34-1. Purpose. From time-to-time Loan Management Staff are asked to process special rent increases for projects that have been sold at foreclosure sales to third parties or sold by HUD, as a HUD-owned property. In either case, if a property was sold without financing, there are special processing procedures that must be followed. These procedures are intended to provide a mechanism to deal with projects that were financed by the owner after acquisition on an all-cash basis.

For purposes of processing the special rent increase in such cases, HUD will assume that owners retain equity of 20 percent and that a return of ten percent on that equity is reasonable. This mechanism allows HUD to recognize debt that is placed on a project after it is sold at a foreclosure sale or sold by the Department from HUD-owned inventory. These instructions provide a mechanism for determining a project's cash flow needs which include after sale debt.

- 34-2. To calculate Special Adjustments for Property Disposition Properties. For a property sold with Property Disposition Section 8 (Part 886, Subpart C), HUD elects to calculate rent increases in one of two ways:
- A. For properties sold with mortgage insurance or purchase money mortgages, rent increases must be calculated using the budgeted rent increase method, unless otherwise expressly stated by HUD. This is an effort to protect HUD against future claims and losses. NOTE: The process of calculating a special rent increase is strictly for use with the AAF rent increase method. However the figures calculated in the formula below, should be built into the budget when calculating rents using the Budgeted Rent Increase Method. Section 3 of this chapter does not apply to budget based rents. For further information on calculating this type of rent increase, reference should be made to Chapter 7 of this handbook.

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- B. For noninsured and coinsured properties, rent increases must be calculated using the AAF, unless otherwise expressly stated by HUD, as HUD is not at risk.

If an owner is in question concerning what type of rent adjustment is being administered to a Property Disposition Property with Subpart C Set Aside, they should refer to their regulatory agreement. If a regulatory agreement is present, then the rents will be adjusted utilizing the Budgeted Rent Increase method, unless the project is coinsured. Otherwise, the rents will be adjusted utilizing the Automatic Annual Adjustment Factor (AAF). More detailed information on specific types of properties subject the Budgeted Rent Increase Method can be found in Handbook 4350.1, Chapter 7.

These computations will utilize form HUD 9650, Sales Analysis, which is enclosed in the Property Disposition Project File. A sample HUD 9650 and HUD 9833B illustrating this calculation are contained in Appendices 1 and 2. Use the following formula for both types of rent adjustments:

Step 1. Calculate the Debt Service: (Debt is assumed to be equal to 80% of the Repaired Price stated on form HUD 9650.)

- A. When the form HUD 9650 is dated 8/91 or later, use Line 19 of the HUD 9650 to retrieve the interest rate and term. This will be applied to 80% of the Repaired Price on line 38 of the HUD 9650.

Example: Line 19 - 8% at 40 years; Line 38 - \$1,000,000; Debt (80% of line 38) = \$800,000

- B. On form HUD 9650 dated prior to 8/91 or if debt service is not specified on the 9650: Use 10% interest over a 40 year term. This will be applied to 80% of the Repaired Price on the HUD 9650.

Example: Repaired Price = \$1,000,000;
Debt (80% of Repaired Price) = \$800,000.

Step 2. Calculating debt service amount for form HUD 9833B:

- A. When the form HUD 9650 is dated 8/91 or later, take numbers retrieved in Step 1(A) (interest rate, term and debt) and calculate the debt service. This is done by applying the appropriate debt service rate to the debt. These rates are found in Appendix 3, and will produce the annual debt service.

Example: \$800,000 (Debt) x .08343740
(Rate at 8% for 40 years) = \$66,750
(Annual Debt Service)

- B. On form HUD 9650 dated prior to 8/91 or if debt service is not specified on the HUD 9650, take the number retrieved in Step 1(B) (debt) and multiply by .10189751 to obtain the annual debt service.

Example: \$800,000 (Debt) x .10189751
(Rate at 10% at 40 years) = \$81,518
(Annual Debt Service)

Step 3. Insert the annual debt service on form HUD 9833B, Page 6, Line 8 of Part G: Special Adjustments for Taxes, Insurance or Utility Cost Increases for Annual Adjustment Factor (AAF) Rents. For Budgeted Rent Increases this figure should be built into the annual budget as Debt Service. For further directions on calculating Budgeted Rent Increases see Handbook 4350.1, Chapter 7.

Step 4. To calculate the allowable distribution amount:

Take 2% of the As Repaired Price, which is the same as 10% of the initial 20% defined by HUD as owner equity. On form HUD 9650 dated 8/91 or later, this figure is stated on the form as a fixed dollar amount on line 44 and will not need to be calculated. This number will remain the same from year to year.

Step 5. Insert the figure calculated in Step 4 (or retrieved from line 44 of the HUD 9650) on form HUD 9833B, Line 13 of Part G: Special Adjustments for Taxes, Insurance or Utility Cost Increases, for Annual Adjustment Factor (AAF) Rents. For Budgeted Rent Increase this figure should be built into the annual budget.

Once these figures are inserted into the specified calculations, the special adjustment processing should continue as described in Section 3.

SECTION 3: CALCULATING SPECIAL RENT INCREASES FOR AAF RENTS

- 34-3. Purpose. This section will discuss the types of special rent increases that are allowed by law for rents calculated using the Annual Adjustment Factor (AAF) method, and steps required to request and process a special increase in rents.
- 34-4. Types of Special Rent Increases. A special adjustment may be requested by the owner for property taxes, utilities and hazard insurance. For Property Disposition properties sold on a "cash as is" basis, be sure to figure the allowable debt service and/or distribution amount as described in Section 2 prior to calculating a special adjustment.
- 34-5. The Consideration of Special Adjustments for Property Taxes, Insurance and Utilities. Prior to the consideration of special adjustments the Loan Management Staff should evaluate the owners request and make sure the owner has taken the required steps prior to requesting a special rent increase. Increases in these items which went into effect prior to the last processed annual adjustment should not be considered for a special adjustment. Only increases in those items which will be implemented soon (e.g. within 90 days) should be processed.
- A. Property Taxes. The owner is required to take into consideration the reason for the new increase in property assessment and take all reasonable actions under local law to appeal the increased property assessment. The requirements of the owner prior to requesting a special rent increase for property taxes should include the following:

1. The owner should apply for all tax reductions available to the specific type of project. Loan Management Staff should be consulted as to what type of reductions are available in the property's jurisdiction. The owner should also consider consulting a tax professional to review and appeal the tax assessment on a contingency basis. If this service is not available on a contingency basis, the expense can be considered a project expense and paid from project income. If the amount of project funds utilized for this service will exceed \$10,000 prior HUD approval is required. At the discretion of the Director of Housing Management, a fee may be built into the rents to permit the owner to maintain an attorney on a retainer basis to appeal tax statements which would require a rent increase at the project. Loan Management Staff should require the appropriate documentation to assure HUD interests are protected when dealing with identity-of-interest situations.
2. As a part of the rent increase submission, the owner should certify that:
 - a. taxes have been reviewed and, where appropriate, appealed;
 - b. if the appeal results in a tax refund, the owner will return the refund to the project in the manner specified by HUD; and
 - c. if the appeal results in a lower assessment, the owner will reduce the rents at the project commensurate with the reduced assessment.

If at the time of the needed rent increase, the owner has had insufficient time to appeal the tax increase or if the tax appeal is in processing, the Loan Management Staff should include the current tax amounts in the rent increase, as well as any past due tax amounts, with the assurance of the signed certification. This certification explicitly states that any tax refund received must be returned to the project operating account. A sample certification is attached in Appendix 4.

For further information on Real Estate Assessment and Tax Appeal see Chapter 23 of Handbook 4350.1.

- B. Insurance. The owner must be able to certify that the amount of increased insurance is the best rate obtainable by the project. This can involve obtaining bids on comparable policy rates, disclosing identity of interest relationships and other disclosures that may be required by HUD.
- C. Utilities. Prior to considering the special request the Loan Management staff should determine if the owner has analyzed rates and requested rates which are the most advantageous to the project. Loan Management Staff should also ensure that the owner is in compliance with HUD's Energy Conservation requirements as developed in Chapter 12 of this handbook. It should be determined that the owner is taking all reasonable actions to ensure that the energy consumption levels and rates are as low as possible. This may include an independent review of past billings and rates to assure that past overcharging did not occur and a refund is due to the project.

34-6. Processing the request for Special Adjustments. Once the owner has satisfactorily met the above requirements for consideration, the Field Office should then proceed with processing the special rent increase using form HUD 9833B, Part G: Special Adjustments for Taxes, Insurance or Utility Increases and in accordance with the following instructions.

- A. For each item (taxes, insurance and utilities) the difference between the new annual expense and the previous annual expense should be derived. Be sure this figure does not include any escrow shortages, however it should include past due amounts. Once the individual figures are derived they should be added together for use in determining the maximum special rent increase.
- B. Using the new annual amount for each item, a new cash flow should be estimated prior to the distribution as well as after the allowable distribution, using the following formula.

AAF Annual Rent Potential
x Estimated Occupancy

+ Miscellaneous Income
- Debt Service, Reserves and Operating Expenses (figured with the new annual amounts for taxes, insurance and utilities as well as the amount calculated in Section 2, if the property was an All Cash Sale PD property)

Cash Throw Off before Distribution Allowance
- Distribution Allowance (include the distribution allowance calculated in Section 2, if applicable)

Cash Throw Off after Distribution Allowance

- C. If cash throw off after distribution is zero or positive then no special rent increase will be permitted. If the cash throw off is negative, then the maximum special increase permitted will be the lower of:
1. the change in taxes, insurance and utilities;
or
 2. the shortfall in cash throw-off after the distribution allowance.
- D. Consider the feasibility of using residual receipts to reduce the special increase by taking into consideration other possible demands on the account as well as how many years are remaining in the Section 8 contract. The Loan Management Branch Chief should determine when it is feasible to fund all or a portion of the special increase from the residual receipts account.
- E. Document any use of residual receipts and for which purposes it will be used. If these funds will be released for taxes and insurance, they should be released directly to the mortgagee and only at the time the funds are needed.

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Appendix 4

Sample Certification

Tax Review and Appeal

Project

Name: _____

Project

Number: _____

Acting on the behalf of _____,
the project owner, I certify that all of the following statements
are true:

1. The tax assessment and bills for the project have been reviewed for appropriateness and mathematical accuracy and have been appealed where found to be inappropriate and/or inaccurate.
2. Where the taxing jurisdiction so permits, a tax reduction/exemption (choose one) has been requested. A copy of the appeal is attached. A decision on the appeal is expected by _____ (date).
3. If the tax appeal results in a tax reduction, the rents at the project will be reduced commensurately unless HUD decides the rental income may be used for other legitimate operating expenses.
4. If the tax appeal results in a refund, the refund will be returned to the project operating account and utilized only in the manner specified by HUD.

WARNING: 18 U.S.C. 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document or writing containing any false, fictions, or fraudulent statement or entry, in a manner with in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than five years, or both.

Signed by:

Name

Title

Signature

Date

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