

CHAPTER 7. PROCESSING BUDGETED RENT INCREASES
AND FEES FOR COMMERCIAL SPACE AND SERVICES IN
INSURED, DIRECT LOAN AND NON-REGULATED HUD PROJECTS

SECTION 1. OVERVIEW

- 7-1. PURPOSE. This chapter provides procedures for processing budgeted rent increases in certain HUD projects and outlines guidance in the calculation of utility allowances and charges for commercial facilities and services provided in those projects. Included in the chapter are the relevant tenant participation procedures which must be followed in processing these increases and charges. In preparing the procedures in this chapter, HUD's prime interest is in promoting the efficient management and continued financial viability of its projects. In reviewing requests from owners concerning rents and charges, the Field Office should be guided by the fact that these rents and fees should and must provide sufficient and adequate funding to operate the projects. This chapter gives guidance on program evaluation used in conjunction with required procedures for MIPS budgeted rent increases.
- 7-2. APPLICABILITY. These procedures for processing a gross potential rent increase, increases in charges for commercial space and charges for services apply to the projects listed below:
- A. Section 231, and 221(d)(3) market rate projects: 231 projects (LDs) whose rents are still controlled or who have opted for the alternate rent mechanism.
 - B. Section 202 projects, except those that use the Section 8 Annual Adjustment Factor (AAF).
 - C. Section 213, Section 236 (including cooperatives), Rent Supplement, 221(d)(3) market rate and 221(d)(3) BMIR rental and cooperative projects, Sections 810 and 908 (military housing);
 - D. Projects that have converted from Rent Supplement to Section 8 Loan Management Set-Aside;

- E. Previously HUD-owned projects that have been sold to nonprofit owners or that use a budget (rather than the Section 8 AAF) to compute rents;
- F. Section 207's and 231's both regulated and controlled by alternative rent mechanism; Section 220 and 221(d)(4)'s that are regulated; and 234 rentals that did not convert to condominiums;
- G. Those projects listed in paragraph 7-2(A) through (F) that are not automatically preempted by HUD and request exemption from local rent control.

NOTE: Regulatory agreements require Section 202, Section 231 and cooperative projects to annually submit operating budgets and obtain HUD approval of rents or carrying charges. Field Offices shall enforce this requirement in lieu of the requirement that budgets be submitted only when the owner believes a rent increase is needed.

The Field Office in enforcing the regulatory agreement requirement for annual budget submissions, shall require the owner to include in their submission any information required by Section 4, paragraph 7-22 of these procedures.

7-3. PROJECTS SUBJECT TO THE ALTERNATE RENT DETERMINATION MECHANISM.

For projects insured under Section 207, 231(c)(4), 213 Rental, 223(f), and 234 Rental prior to November 30, 1983, and for 221(d)(4) projects, regardless of when the project was insured, the owners may request an amendment to the Regulatory Agreement subject to Section 3 of this chapter requiring HUD to determine their rents using the alternative rent mechanism described in Section 4.

7-4. DEFINITIONS.

- A. HUD Authorized Rent. These are the unit rents shown in column 3 of the most recently approved Rent Schedule (Form HUD-92458). In the Section 236 program these rents are called basic rents. Depending on income, some 236 tenants will pay

market rent or something between basic and market rents which represents 30 percent of adjusted

income.

- B. Maximum Allowable Rent Potential. The maximum annual rent the owner may collect by charging the rents authorized by HUD on the Form 92458.
- C. Utility Allowance. (APPLIES ONLY FOR PROJECTS RECEIVING SUBSIDY ASSISTANCE WHERE ALL OR SOME UTILITIES ARE PAID DIRECTLY BY THE TENANT.) An estimate of utility costs (except telephone) for an average family occupying a unit.

Clarification: Section 221(d)(3) BMIR projects that were built with tenant paid utilities (separate meters) do not need utility allowances. If the project has Rent Supplement or LMSA units, those units however, receive an allowance.
- D. Section 8 Contract Rents. The rent level called for under the subsidy contract and adjusted annually. Rent used for units subsidized under Section 8 (LMSA) where the owner has had his rent decontrolled or used the alternative rent mechanism.
- E. Services. This refers to such benefits as may be provided by the project owner to tenants that are not included in the rent and are optional on the tenant's part (i.e., cable T.V., laundry facilities and use of community space in the project.)

SECTION 2. TENANT COMMENT PROCEDURES FOR A RENT INCREASE

- 7-5. GENERAL. Tenant comment procedures for the rent increase process are provided for in Section 202(b)(1) of the 1987 Housing and Community Development Amendments (HCDA) and Section 329(F) of the 1981 HCDA. Regulations at 24 CFR 245 set the Department's policy on the subject (See Appendix 1). These requirements for tenant comment on rent increases and utility allowance reductions apply to all projects listed in Section 1, Paragraph 7-2 except those rentals under Section 207, 213, 234, Section 231, 220 and Section 221(d)(4) and 202s assisted under Part 885. They also

do not affect cooperatives whose residents elect a Board of Directors which must approve any proposed increase in carrying charges. This mechanism more than

provides a means of comment in the management of the project.

- 7-6. APPLICABILITY, The requirements of this section affect ONLY those owners whose requested rent potential would exceed the Maximum Allowable Rent Potential for that project. If the proposed rent potential is less than or equal than or equal to the Maximum Allowable Rent Potential, the tenant comment procedures outlined in this section do NOT apply. (See Section 4.)
- 7-7. OWNER RESPONSIBILITIES: Owners must issue a Notice to Tenants of any proposed rent increase. The Notice must contain all of the information included in the sample notice shown in the Appendix 1. initial submission of the request to HUD for a rent increase shall go forward at the same time as the Notice is being given to tenants. The HUD Field Office shall receive a copy of the Notice to Tenants along with the documents and information that will be used to justify the rent increase as part of the formal rent increase request.
- A. For high-rise projects, owners must "post" or "deliver" the Notice to each tenant. For all other types of projects, owner need only "deliver" the Notices.
 - B. Delivery. A copy of the Notice must be mailed to each tenant or hand carried directly to each unit. IMPORTANT: The Notice should also be delivered to those tenants who pay market rent and to tenants who would not be affected by an increase because they pay a percentage of income.
 - C. Posting. If applicable, the owner must post the Notice in at least three conspicuous places in each high-rise building in which dwelling units are located AND in one conspicuous place at the address where the material supporting the owner's request will be available for tenant review and copying.

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IMPORTANT: Owners must keep the posted Notices in place and in legible form for the tenant comment period.

- 7-8. TENANT REVIEW AND COMMENT. During the 30 days following the date the Notice to Tenants was given, the owner must make all of the materials listed in Section

4, paragraph 7-22 plus any additional information used to justify the increase available to tenants or their representatives to review and/or copy. For the purpose of computing tenant comment periods, owners must consider the date the Notice was given to be the date by which all Notices had been hand carried or mailed and all required copies had been initially posted. The materials must be available at least during normal business hours.

- 7-9. COMMENT SUBMISSION. Tenants may submit written comments on the increase request to the owner or to the HUD Field Office or both. In cases where comments are submitted to the owner, all such comments must be reviewed and evaluated. The comments and evaluations should then be forwarded to the HUD Field Office as part of the formal rent increase request.
- 7-10. CHANGES TO SUPPORTING DOCUMENTATION. If during the 30 day comment period the owner makes a material change in any of the documents submitted in support of the increase, the owner must notify the tenants of the change(s) in a notice to be distributed in the exact same manner as the original Notice to Tenants. The owner must make the revised materials available for the tenants to review and/or copy for the LONGER of 15 days after the revised notice was given or the days remaining in the initial 30-day comment period.
- 7-11. SUBMITTING THE FORMAL REQUEST FOR AN INCREASE. At the conclusion of the tenant comment period as defined in either paragraph 7-8 or paragraph 7-10 above the owner must forward in addition to the tenant comments and evaluations, an executed copy of the owner's Certification as to Compliance with 24 CFR Part 245's Review and Comment Procedures. (See Appendix 2)

SECTION 3. DECONTROL OF RENTS

- 7-12. DECONTROL OF SECTION 220/221. On April 19, 1983 the Department issued regulations (effective 6/1/83) which changed the requirements for HUD control of rents and other charges in Section 207, 220, and 221(d)(4). First, HUD used the discretion it already had under Sections 220/221(d)(4) to decontrol rent and other charges in unassisted projects. Regulation would continue only for projects receiving certain types of Section 8 assistance, projects receiving Section 8 LMSA and projects insured under Section 221(d)(3). The

regulation of certain charges for facilities and services continued for each of these units and projects, as well as for Section 221(d)(4) elderly and handicapped projects. Second, HUD implemented the Alternative Rent Mechanism (discussed in Section 4 of this chapter) for determining maximum allowable rents for unsubsidized projects insured under Sections 207, 213 (rental), 223(f), 231(c)(4) and 234(rental).

7-13. HURRA OF 1983. In November 1983, Section 431(a)(1) of the Housing and Urban-Rural Recovery Act of 1983 amended section 207(b)(2) of the National Housing Act (NHA) to make discretionary the Secretary's authority to regulate rents and other charges for multifamily housing projects insured under Section 207 on or after November 30, 1983. The owner needed only to submit an amended regulatory agreement and HUD would sign it.

7-14. DECONTROL OF SECTION 207. Exercising the discretion granted by the change in 431(a)(1), the Department implemented regulations on June 4, 1986 (effective 7/21/86) which deregulated rents and other charges for mortgages insured under Section 207 on or after November 30, 1983. Regulation continued for Section 236 subsidized projects refinanced under Section 223(f). HUD also authorized owners of 221(d)(4) and 220 projects with LMSA to decontrol rents provided they amended the Regulatory agreement and to have its Section 8 rents determined annually by the applicable annual adjustments factor.

7-15. SECTION 207/LMSA. For those projects insured before November 30, 1983, the 1986 regulations gave Section 207, 220, and 221(d)(4) project owners receiving

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Section 8 LMSA assistance the option to request the Alternative Rent Mechanism, provided they agree to amend the Regulatory agreement, and have the Section 8 rents determined by the applicable annual adjustment factor.

7-16. 1987 HOUSING ACT. The Housing Act of 1987 imposed restrictions on the decontrol of rent and use of the alternative rent mechanism which affected owners who had not requested changes in their regulatory agreements. For those owners whose request for a regulatory change was received before 12/1/87, HUD will process the request and sign the new agreement. However, for owners of projects who were eligible under

the 1983/86 regulations BUT who did not request the necessary amendment prior to 12/1/87, the Act requires that the project meet the following tests before the amendment can be approved: (1) The project may not have a project based Section 8 contract; and (2) no more than 50 percent of its tenants can be defined as lower income.

- 7-17. PROJECTS NOT COVERED BY THE 1987 ACT. Projects endorsed and insured (or co-insured) on or after 11/30/83 under Section 207 and 223 are NOT covered by the 1987 Housing Act. This is notwithstanding any language presently contained in the regulatory agreement.
- 7-18. PROJECTS COVERED BY THE 1987 ACT. The Field Office will apply the tests required in the 1987 Act to:
- (A) Unsubsidized Section 207, 213(rental), 223(f), 231(c)(4), and 234 (rental) projects that could have elected the Alternative Rent Mechanism under the April 19, 1983 rule, but did not do so before 12/1/87.
 - (B) Unsubsidized 220 and 221(d)(4) projects insured prior to 6/1/83 who could have elected to deregulate charges for rents, facilities, or services under April 19, 1983 rule, but did not do so before 12/1/87.
 - (C) Section 207, 213(rental), 223(f), 231(c)(4), and 234 (rental), 220 and 221(d)(4) projects insured prior to 11/30/83 and assisted by Section 8 LMSA

that were permitted by the June 4, 1986 regulation to request the Alternative Rent Mechanism or decontrol as applicable, but did not do so before 12/1/87.

- 7-19. SPECIAL CASES. HUD continues to regulate a certain limited class of projects which would otherwise be eligible under regulations to request decontrol. This group consists of those projects discussed in this Section where the mortgagor opts to remain controlled in order to maintain the project's tax exempt status and those projects where deregulation would result in the imposition of local and state rent control which is inapplicable as long as HUD is regulating the rent. In both cases the maximum permissible rent charges are

determined by the Alternative Rent Mechanism.

- 7-20. PMMs. Regulation of rents at projects with Purchase Money Mortgages sold with insurance will be in accordance with the rules for Section 221(d)(4).

SECTION 4. OWNER REQUEST FOR A RENT INCREASE

- 7-21. PROCEDURES FOR REQUESTING A RENT INCREASE. Owners are allowed to charge only the rents shown on the rent schedule they submitted and which have most recently been authorized by HUD. When current rent levels are NOT sufficient to cover anticipated or unavoidable increases in operating costs, owners should request that HUD approve an increase in rents. If the increase in proposed potential rent is less than or equal to the Maximum Allowable Rent Potential, owners need only submit a new Rent Schedule 92458. Tenant comment procedures in 24 CFR 245 do NOT apply. If the proposed rent increase exceeds the Maximum Allowable Rent Potential, owners must take the actions discussed in this Section.

- 7-22. INITIAL SUBMISSION. In addition to the proposed rent potential, the initial submission to request a rent increase should include the materials listed below, plus any additional documents being used to support the request.

- A. A cover letter that briefly does all of the following:

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- 1) Summarizes the reasons why a rent increase is needed and the date the increase will be effective. Describe the project's physical condition and any improvements that have been budgeted for. The letter may refer to the reasons stated in the Notice or elaborate on those reasons. (The main reasons stated in the letter must be the same as the main reasons stated in the Notice to Tenants, if the project was subject to the tenant comment procedures in Section 2.)
 - 2) Identifies any proposed change in services, equipment or charges and the reasons for the change.
- B. A Budget Worksheet (Appendix 4(d) format)

providing income and expenses for the 12 months following the anticipated effective date of the proposed rent increase.

- C. A brief statement explaining the basis for any increase in the expense line items on the budget work sheet. Generally, if an increase amounts to 5 percent or more, it must be documented. If the income or expense was estimated at the prior annual period's actual, or the increase is less than \$500, no explanation is required. (Appendix 4(b) provides a sample owner explanation of budget items.)
- D. Where applicable, a copy of the Notice to Tenants annotated to show where and how the Notice was distributed (e.g., posted, mailed, hand carried).
- E. An executed copy of the Owner's Certification Regarding Purchasing Practices and Reasonableness of Expenses (Appendix 3).
- F. A status report on the project's implementation of its current Energy Conservation Plan (See Chapter 12). This may be: (1) a narrative report coded to facilitate references to the plan; or (2) copy of the plan annotated to show the current status of

all items that were scheduled to be completed within 60 days after the rent increase is proposed to be effective. THIS APPLIES ONLY TO SECTION 236 AND BMIR PROJECTS, PROJECTS THAT RECEIVE RENT SUPPLEMENT ASSISTANCE, AND PROJECTS THAT CONVERTED FROM RENT SUPPLEMENT TO SECTION 8. This requirement is to assure compliance with Section 329(c) of the Housing and Community Development Amendments of 1981.

- G. A signed request for an increase in the Reserve for Replacement if such an increase is contemplated as part of the rent increase request (Appendix 6).
- H. For Protects with Utility Allowances, a recommendation to what utility allowance is appropriate for each unit type and a summary of how the owner/agent arrived at that amount with appropriate documentation as prescribed by paragraph 7-24 of this section.

7-23. USE OF THE ALTERNATE RENT MECHANISM. For projects insured under Section 207, 231(c)(4), 213 Rental, 234 Rental, 223(f) and 221(d)(4), where the necessary amendment to the regulatory agreement has been executed (See Section 3), owners may request that HUD determine a rent increase using the Alternative Rent Mechanism. These steps are to be followed:

- A. Owner Submission for Alternative Rent Determination mechanism. In addition to the information required in Section 4, paragraph 7-22, the owner who chooses the Alternative Rent Determination process must submit the following:
- 1) An appraisal of the residential value of the property performed by a qualified real estate appraiser of the mortgagor's choice which includes the comparable rents for units in similar projects.
 - 2) A request for HUD approval of a rent increase.

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- B. Processing Procedures for Budgeted Rent Determination.
- 1) Section 207, 231, 213, 220, 221(d)(4) owners or owners of projects which are required to have their rents approved by HUD, who do not choose to use the Alternative rent Determination procedures will continue to have their rents determined as prescribed in this chapter and no Regulatory Agreement amendment is necessary.
 - 2) Section 207 owners or owners of projects who require HUD approval of rents or owners of projects who otherwise could chose not to have HUD control rents, that wish to use the Alternative Rent Determination Procedures provided for, shall have their rent determined by HUD based on the submission required in paragraph 7-23(A) of this section. HUD will approve the lower of the following two rent potentials: (1) apply the original debt service factor to the current market appraisal covering the residential value of the property. Then process the

rents as outlined in this chapter, to determine Gross Potential Rent; or (2) the comparable rents submitted as part of the appraisal.

NOTE: The independent organization or person hired by the owner to conduct and provide the certified appraisal must be a recognized professional appraiser. The appraiser in making his/her rental analysis must determine the residential rental income separate from the commercial income and provide a delineation in the value of the residential portion separate from the commercial portion of the value. The Field Office in determining the Gross Potential Rents using the new appraisal will use the residential rent portion of the certified appraisal to apply the original debt service factor set at the time of final endorsement in determining the new debt service allowed in the rent computation and insert the new appraised residential value in Box H of the Rent

Calculation Worksheet. Offices shall follow outstanding instructions contained in this chapter in processing the expenses used in determining the final Gross Potential Rent.

- C. HUD's Approval of Alternative Rent Increase Method.
- 1) Based on the analysis submitted and assuming the owner is otherwise eligible for a rent increase as covered in this chapter, the Loan Management Branch Chief (LMBC) shall approve in writing the lesser of the rents computed in paragraph 7-23(B)(2) of this section.
 - 2) If the LMBC determines that the owner is not entitled to a rent increase as covered in this Handbook, the LMBC shall submit the finding(s) to the Director of Housing Management or Director of Housing for review. The Director will deny or approve the LMBC finding in writing providing the reasons for the final decision if it reverses or alters the LMBC recommendation.

D. Future Processing After Initial Determination of Rents Using Alternative Mechanism.

- 1) If the rent based on comparables and supported by the appraisal as defined in paragraph 7-23(B)(2) are less than the processed rent utilizing the appraised value, use the comparable rents submitted by the owner as the approved rent. The Field Office is NOT to become involved in determining comparable rents. This should already have been done as part of the appraisal package.
- 2) If the budgeted rents in paragraph 7-23(B)(2) using the most recent appraisal and current operating costs are less than comparable rents, the budgeted rent level shall be approved. For future requests, continue this

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process until such time as the comparable rents are less than budgeted rents. When this happens, the comparable rents shall be approved as the Rent Level.

- 3) As long as the owner submits a comparable Rent Level which is less or equal to the rent level that would be provided using the last appraised value in determining rents as described in paragraph 7-23(B)(2) of this Section, a new appraisal is not required. However, when the comparable rents exceed the rents allowed using the last appraised value, then the owner must either submit a new appraisal showing that the rents based on the appraisal are more than the rents based on comparables in order to charge the comparable rents or he/she must charge the rent as determined by using the new appraisal which is less than the comparables.
- E. Thirty Day Processing of Alternative Rent.
The LMBC must (in writing) approve, disapprove or approve for a different amount requested by the owner within 30 days of receipt. Failure on the part of the LMBC to notify the owner in writing of the findings will provide temporary authority to the owner to charge the proposed rents. In the event that the owner implemented the rents at the end of 30 days without HUD's written approval, the

additional rents shall be placed in an escrow account or a letter of credit shall be provided so that in the event HUD fails to approve the rent increase, or approves the increase for less than requested, the owner shall immediately return to the tenants that portion of the rent collected which HUD later disapproved. This applies only to rents processed using the alternative rent mechanism.

F. Allowable Project Costs.

While the cost of the appraisal and/or market analysis can be paid for out of project income, it is not to be used as an allowable project expense in the rent determination defined in Section 5 of this chapter.

7-24. DETERMINATION OF A UTILITY ALLOWANCE. (see Section 1, para 7-4c for applicability) for each request for an increase in the HUD authorized rent potential, the owner must recommend a utility allowance for each unit type. The recommended utility allowance should represent the owner's best estimate of the average monthly utility cost that an energy conscious resident will incur for the year. The utility allowance is not meant to pay all actual utility costs, but rather it is to reimburse a prudent utility consumer for their utility expense. Both the proposed and the current allowance levels should be included in the notices to the tenants.

A. As part of the submission for an increase or decrease in the utility allowance, each owner must submit a summary supporting the proposed change to the utility allowance. That summary should:

- 1) Identify the type of utilities covered by the utility allowance (e.g., gas for heating).
- 2) State whether any utility rate increases or decreases were implemented during the past 12 months or are expected to be implemented during the next 12 months and the amount of those increases or decreases.
- 3) State how any energy conservation initiatives have or will impact consumption.

B. In addition, the owner must request HUD approval

of revised utility allowances whenever a utility rate change would cause a cumulative increase of 10 percent or more in the most recently approved utility allowances.

- C. Owners must recommend additional utility allowances if the project's design is such that utility costs will vary significantly for units of the same size (e.g., end units vs. interior units).

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FIELD MANAGEMENT OF THE RENT REQUEST PROCESS.
Field Offices must establish a tracking system that will facilitate and monitor compliance with the following processing times:

- A. When the Proposed Potential does NOT exceed the Maximum Potential. In these instances, the Field Office need only review the proposed utility allowances and the Rent Schedule. Field staff should complete these actions and return the signed Form 92458 within 10 working days of receiving the owner's request.
- B. When the Rent Increase Exceeds the Maximum Potential,
 - 1) All Projects. The Field Office should check the completeness of the owners, initial submission within 5 working days of its receipt. Doing so will expedite any required reposting and reduce processing delays.
 - 2) Projects NOT subject to 24 CFR 245 Tenant Comment requirements. Complete these reviews and issue a decision letter within 30 days after receipt of all materials required by Section 4, paragraph 7-22.
 - 3) Projects subject to 24 CFR Tenant Comment procedures. Issue decision letters within 30 days after receipt of the formal rent increase request which includes the tenant comments and other materials required by Section 2, paragraph 7-11. Final approval cannot take place before the tenant comment period has ended.
- C. Check the completeness of the Owner's Initial

Submission. Within 5 working days of receipt of the owner's initial submission, answer the following questions where applicable.

- 1) Does the Notice to Tenants contain all of the information included in the sample notice in Appendix 1? If it doesn't, require the owner to revise the Notice and distribute it as directed.

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- 2) Has the owner submitted ALL of the materials required by Section 4, paragraph 7-22? If not, do the following.
 - a) Call the owner/agent and ask them to submit the missing materials and follow up in writing,
 - b) Be sure the missing materials are made available for any required tenant review. (See Section 9, paragraphs 4, 5 and 6.)
- D. You may NOT require that projects routinely submit materials NOT listed in Section 4, paragraph 7-22. You may require additional submissions ONLY if the actual or projected expense estimates appear to be excessive and the narrative without additional information, cannot support requested expense levels. Special requests should only be made in cases where estimates will have significant monetary impact on the authorized rent potential.

NOTE: Your requests for additional information must be made in writing and within 30 days of receipt of initial package. The owner must distribute a second Notice to tenants and comply with Section 2, paragraph 7-10 where applicable. Be flexible, consider the needs of the project tenants and protection of government interest before requesting additional information.

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SEASONAL RENTS

- A. The housing programs of HUD contemplate relatively permanent occupancy at rents within the ceilings established for year-round occupancy, hence seasonal rents are not generally in accord with the objectives of those programs. In particular,

occupancy charges at seasonal rates would be inconsistent with the objectives for which projects are built for cooperative use or for use by families of low and moderate income, or for elderly occupants.

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- B. Conversely, in areas where seasonal rents are customary, there may be rental housing projects which experience financial difficulty because year-round occupancy cannot be maintained. In such circumstances, HUD will not object to the establishment of seasonal rents for a temporary period provided that:
- (1) Preference at all times in all units will be given to permanent tenants at the established year-around rental rate.
 - (2) None of the units in the project will be rented for a period of less than 30 days.
 - (3) There will be no increase in existing maximum permissible gross rent by reason of seasonal rates being allowed, and as to the individual units, the aggregate gross rent collected during any fiscal year should not exceed the established maximum rent.
 - (4) Seasonal rents are not permitted in any project receiving a project-and/or mortgage-based subsidy.
- C. If examination of the project operations supports the need for seasonal rents, the Housing Management Division (or Insuring Office) Director will grant approval in the form of a letter agreement which shall define the number and type of units so covered, and shall evidence the mortgagor's acceptance of the foregoing conditions under which approval is given. Deviations from the terms under which approval was obtained will operate to breach the agreement.
- 7-27. BMIR RENTS PAID BY OVER-INCOME TENANTS. HUD-91709, Schedule of Computation of Rental Income in Excess of BMIR Rent Paid by Over Income Tenants, is a monthly schedule to be completed by BMIR mortgagors in order to compute the amount of rent in excess of BMIR rent paid by over-income tenants. These funds are available for

credit to the residual receipts account if the project has a surplus cash position at the end of the fiscal year. The completed form shall be used by Housing Management Division personnel and project accountants

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to arrive at this amount without having to review all of the project's records by lease, Form HUD-91705, etc. This will not, however, eliminate the need to spot-check these records when determined necessary to assure correctness of the schedule. Unless requested by HUD, this form is retained as a part of the mortgagor's record.

7-28. SECTION 236 PROJECTS. RENTS COLLECTED IN EXCESS OF BASIC RENT.

For all types of Section 236 projects, including noninsured projects, the Regulatory Agreement or the Interest Reduction Contract provide that, subsequent to the commencement of the term of the Interest Reduction Contract, the project owner shall remit each month the amount by which the total rentals collected on the dwelling units exceed the sum of the approved basic rentals. The prescribed reporting form, Monthly Report of Excess Income, Form HUD-93104, must be submitted by the tenth of each month, whether or not a remittance is required. Mail the Form to the address printed on the Form.

- A. Determining the Amount of Excess Income, In order to determine the amount of excess income, if any, which must be remitted to HUD, the project owner must prepare HUD-93104A, as of the end of the reporting month, or have the same information shown on this detailed schedule readily available from some other source, such as a computer printout sheet. This schedule must be attached to the retained copy of Form HUD-93104, and made available, upon request, for audit by HUD or the Comptroller General of the United States.
 - B. Collecting Excess Rentals Prior to the Commencement of the Interest Reduction Contract. Any excess rentals collected prior to the commencement of the term of the Interest Reduction Contract shall not be treated as a return of subsidy to HUD but as regular project income.
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- C. Adhering to Excess Income Requirements. The Section 236 law states that the project owner shall accumulate, safeguard, and periodically pay to the Secretary all rental charges collected in excess of the basic rental charges." HUD's continued payment of interest reduction subsidy to the mortgagee is contingent on the owner's strict adherence to program requirements.
- (1) The Subsidized Housing Programs Division, Office of Finance and Accounting, shall send to the mortgagor or the designated management agent a demand letter, and one follow-up letter if no answer is received within 15 days. Copies of these letters shall be sent to the appropriate Housing Management Division Director and to the Director, Office of Multifamily Housing Management.
 - (2) Upon receipt of a copy of the first demand letter to the mortgagor, the Housing Management Division Director shall immediately take whatever action is deemed appropriate to obtain compliance.
 - (3) Upon receipt of a copy of the follow-up letter to the mortgagor, the Housing Management Division Director shall intensify efforts to obtain compliance. These efforts shall include, but not necessarily be limited to, immediate notification to the mortgagor by Certified Mail, Return Receipt Requested, that it may be subject to the penalties in D. below unless and until the required Form HUD-93104 together with any amount due, are received by the Mellon Bank Lockbox within 30 days of the date of the letter. (See Appendix 12). Copies of the Notice to the owner shall be sent to the mortgagee; the Subsidized Housing Programs Division, Office of Finance and Accounting and; the Office of Multifamily Housing Management, Operations Division. The Housing Management Division Director shall continue efforts to obtain compliance during the 30-day period.

D. Enforcement actions to be taken by the Director. Housing Management Division. If upon expiration of the thirty (30) days notice, the owner has not complied, the Housing management Division Director shall notify the Director, Office of Multifamily Housing Management, Operations Division, of the noncompliance. The notification shall:

- (1) Provide information as to any circumstances beyond the mortgagor's control or of an unusual or special nature, and
- (2) Recommend imposition of one or more of the following enforcement remedies:

NOTE: Field Offices shall impose enforcement remedies for which they have authority and Make recommendation for approval to Headquarter for actions which have not been delegated.

- (a) Use Residual Receipts to pay excess income; (provided account has ample funds for this and other anticipated needs);
- (b) Suspension or Debarment from HUD Programs;
- (c) Denial of releases of Reserve for Replacement Funds;
- (d) Prohibition of distributions;
- (e) Require repayment of any dividends or distributions improperly paid by the mortgagor to stockholders or partners;
- (f) Require replacement of the Management Entity or Agent;
- (g) Offset subsidy vouchers against excess income due until paid in full (Section 8, Rent Supplement, RAP);

- (h) Suspend interest reduction payments to the mortgagee and in the event the mortgage is insured, upon assignment to HUD, immediately recommend foreclosure;
 - (i) Recommend assessment of Civil Money Penalties in accordance with the provisions of Section 1735f-15 of Title 12 of the United States Code;
 - (j) Assess Double Damage penalties, authorized by Section 1715z-4a of Title 12 of the U.S. Code;
 - (k) Assess interest on the excess income due at the current Treasury borrowing rate, i.e., the cost to the Government for the money;
 - (l) Denial of rent increases, Transfers of Physical Assets, Plans of Action, Equity loans; and other owner-requested actions until delinquent amounts are paid in full;
 - (m) Request the insured mortgagee to accelerate the debt;
 - (n) Request Inspector General to audit the project's books and records;
 - (o) Collect all rents in connection with the project and use such collections to pay excess income and other obligations under the mortgage and Regulatory Agreement;
 - (p) Take over possession and operation of the project; and
 - (q) Apply to any court for injunctive relief, appointment of a receiver, or other appropriate relief.
- (3) The Director, Office of Multifamily Housing Management, if applicable, shall notify the mortgagor by certified mail of the

(30) days. Copies of the letter shall be provided to the Housing Management Division Director; Office of General Counsel and the Subsidized Housing Programs Division, Office of Finance and Accounting, together with any instructions necessary for implementation of the penalties imposed. NOTE: Field Offices shall impose enforcement remedies for which they have authority and make recommendation for approval to Headquarter for actions which have not been delegated.

- (4) If the mortgagor complies with submission and payment requirements subsequent to any penalty imposed, appropriate steps will be taken by the Director, Office of Multifamily Housing Management to restore the privileges taken away.

E. Repayment agreements requested by the owner must be negotiated with the Housing Management Division Director. The Director shall arrange a meeting to negotiate with the owner within two weeks from their request. Repayment plans shall be based upon the following criteria:

- (1) Repayment Agreements shall be in writing, using the Repayment Agreement and Note (See Appendix 14), and executed between the Project Owner and the Housing Management Division Director.

Copies shall be forward to:

Subsidized Housing Programs Division, Office of Finance and Accounting.

- (2) Repayment Agreements shall generally be for twelve (12) months or less in term. Any repayment which would exceed this twelve month period must be justified in writing and approved by the Regional Director of Housing, but shall, in no case, be approved for more than thirty-six (36) months.
- (3) All Repayment Notes must stipulate that failure to pay timely in accordance with the terms of the

Agreement will result in the entire rescheduled amount becoming immediately due.

- (4) Repayment Agreements executed previously shall be incorporated into and made a part of the Repayment Agreement, constituting one (1) Agreement and Note.
- (5) Repayment Agreements shall not:
 - (a) result in any inclusion of delinquent amounts as a line item or portion in the budgeted rent increase processing;
 - (b) result in a reduction of living standards of the tenants;

In addition, where the owner is a limited dividend owner who took a dividend or distribution during the period of delinquency, and the amount due is less than or equal to the amount improperly distributed, the owner shall be required to return the dividend or distribution in a lump sum payment in sufficient amount to repay the outstanding amount due. The owner may accrue any amount returned and repayment to partners may be made at future semi-annual or annual determinations that the project is in a surplus cash position.

- F. Monitoring responsibilities associated with reporting and collection of excess income. The project owner is required to send original Reports, Form HUD-93104, and any Excess Income on a monthly basis to a lock box (Mellon Bank). Copies of these Reports are sent simultaneously to the field office. The lock box forwards excess income funds to the Department of Treasury. Original Reports and collections are forwarded to OFA. Based upon this information, the automated accounting system will generate the following;
- (1) First and second demand letters to delinquent owners.
 - (2) Monthly summary reports for the Field Office which lists owners who are delinquent.

- (3) After demand letters are sent out and owners remain delinquent, Housing Management Division field staff will notify owners to comply by either:

- (a) Remitting the full amount owed, or
 - (b) If extenuating circumstances exist, enter into a repayment agreement.
 - (c) If the owner does not comply, the Housing Management Division should institute enforcement action.
- (4) The Subsidized Housing Programs Division, OFA will provide monthly information to the Director, Housing Management Division in the field office detailing those owners who fail to remit Multifamily Excess Rental Income funds or reports. This is accomplished through the Multifamily Excess Rental Income (MERI) System.

The MERI system will generate four reports on the Field Office Print List (PRTLST) on a monthly basis. The Print List shows outstanding delinquencies for each project. You should contact the Management Information Division in your respective Field Office to coordinate receipt of these reports. The data will be available on the PRTLST the first three workdays of the month.

The reports available are:

- o Statement of Account (A25CHCA). This report, generated monthly, may be produced on request by the Office of Finance and Accounting in Headquarters. The statement provides information regarding reporting and collection activity obtained from the Form HUD-93104, Monthly Report of Excess Income.
- o Monthly Detail of Delinquent Reports (A25DFCB). This listing denotes those projects delinquent in submitting their Form HUD-93104, Monthly Report of Excess Income.
- o Detail Aging of Amounts Due HUD (A25FDCB). This report provides detailed aging data for

each project. The amounts due HUD are for projects which have Form HUD-93104 on file, but did not remit the funds due to HUD.

- o Summary of Delinquencies (A25FICA). This report provides the number of delinquent projects and total amount of delinquencies by

Field Office from October 1985 to the present month.

Loan Management is responsible for obtaining these reports, following up with owners, and monitoring and enforcing program compliance.

- (a) The Director, Housing Management Division shall notify the Director, Subsidized Housing Programs Division, OFA, in writing if any problems are experienced receiving reports timely or regularly, and any other errors, e.g., posting.
 - (b) Section 236 Multifamily Excess Income records will receive greater emphasis by the Housing Management Division during the Management Review process, and on-site physical and occupancy inspection.
- G. Refund of Excess Income. If it is determined that due to a project owner's revision of a prior reporting period(s), that a refund is due, the project owner must request the refund in writing. Refund requests are to be directed to the Office of Finance and Accounting, Subsidized Housing Programs Division, ATTN: Excess Rental Income, 451 7th Street, SW, Room 3206, Washington, D.C. 20410. Project owners are to include the revised reports when requesting a refund. Overpayments cannot be used to offset any future excess rental income."
- H. Considerations in the case of incentives to owners to maintain their projects as low-and moderate-income housing. Title II of the Housing and Community Development Act of 1987, authorizes the Secretary to provide incentives to owners of "eligible low income housing" who agree to maintain their projects as low

and moderate-income housing until the maturity date of the mortgage. In order to provide the owners with a fair rate of return through such incentives, Title II authorizes the approval of higher rents than would otherwise be approvable under applicable program regulations and procedures.

Therefore, in the case of several Section 236 projects that are subject to Plans of Action approved by HUD under Title II, the terms of the Plan of Action provide

for the owner to retain all or a portion of the excess income.

- (1) In such cases:
 - (a) the incentive must be approved as part of the executed Plan;
 - (b) the Plan of Action or implementing Use Agreement must specify the amount and/or term covering the agreed retention period; and
 - (c) the incentives under the Plan of Action may include the retention of prospective excess income amounts, but not the forgiveness of excess income delinquencies accumulated before May 1991.
- (2) Where the owner is permitted to keep ALL of the excess income, the Form 93104 is no longer required to be submitted, for the period covered by the Use Agreement.
- (3) Where the owner is permitted to keep a PORTION of the Excess Income, the Form 93104 is required in accordance-with this Chapter, showing the total excess income due, the amount being retained, and the amount being forwarded to HUD.
- (4) Any agreement entitling the owner to retain all or a portion of the excess income must be documented and made part of the record. The Loan Management Branch must supply this information to the

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Subsidized Housing Programs Division, Office of Finance and Accounting for their records and reporting information.

SECTION 5. REVIEW OF PROJECT INCOME AND EXPENSES

- 7-29. FOCUSING THE REVIEW. Determine if the project has any special conditions that will affect income and expense estimates.
- A. Assess the project's physical condition. To do so, review any:
 - 1) Recent HUD or mortgagee on-site inspections;

- 2) Tenant complaints and any resolutions on maintenance;
 - 3) Energy Conservation Plan on file for the project;
 - 4) Recent replacement reserve analysis or withdrawals;
 - 5) Repair schedules required by TPAs, flexible subsidy contracts, or workout arrangements. (Determine whether project income or other funds will pay these repairs.)
- B. Review available financial information. If applicable, include any recent monthly accounting reports (Forms HUD-93479, 80, 81 or reports comparing budgeted and actual expense) and the MIPS Financial Summary Reports; and the servicer's and IPA's review of the most recent audited annual report.
- C. Review any recent GAO/IG reviews of this project or the agent's management procedures for this or other projects.
- D. Determine if the owner is requesting any change in the services or equipment to be included in the rent. (See the Rent Schedule and cover letter transmitting owner's rent increase request.)

- E. Assess the impact of any procedural changes, repair schedules, escrows, or owner contributions required by any TPA, workout or flexible subsidy contract.
- F. Review the Field Office's files on other projects managed by the owner. Have the owner's past expense projections significantly exceeded actual expenses later reported on the project's financial statements? Have HUD's on-site reviews, the IPA's Report on Internal Controls and Compliance, or GAO's or IG's audits detected serious weakness in cost controls or purchasing procedures (e.g., failure to compare prices or take advantage of discounts)? Is the owner requesting a rent increase to cover expenses and physical improvements for which previous rental increases were authorized? If so, why? If you answered

"yes" to any of the above questions, you should determine why those conditions exist and document this for the record.

- 1) If the conditions are caused by agent's practices, you must scrutinize the budget. You may need to reduce the projections. If reduced, make appropriate notes for the Administrative Review as to why and how you adjusted these expense items.
- 2) If past expenses were excessive and the amount will not be offset by legitimate increases, you may need to allow even less than the prior period's expenses. If reduced, again make notes as to why and how you adjusted these expense items,

- G. ANALYZE THE OWNERS INCOME AND EXPENSE PROJECTIONS. Make an initial assessment during the tenant comment period. If applicable, when tenant comments are later submitted, evaluate whether the tenant comments would change your initial assessment.

Suggested form of letter for use with appropriate

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modifications for type of project and situation by Housing Management Division Directors in accordance with Section 4, paragraph 7-28(C).

- 1) Compare the project's past and present project expenses. Be concerned if the owner's choice of delivery systems causes higher expenses; (i.e., use of an identity-of-interest company or use of contract rather than project staff to do things that might be done by staff. Relatively high costs or rates of increase can be due to special circumstances (vandalism, large number of evictions, emergency repairs). It is project management which is satisfactory to HUD and " give specific answers to questions relative to the income, assets, liabilities, contracts, operations, and condition of the property....").
- 2) Review the owner's expense projections. Be flexible, consider the needs of the project,

the owner's return on investment and maintaining HUD's security interest. Keep in mind that both underestimating and overestimating expenses can have undesirable impacts. If expenses are underestimated, deferred maintenance and defaults can result. If expenses are overestimated, the rents charged will be higher than needed which could result in HUD paying more subsidy than necessary. If the project charges rents which aren't competitive in the market then vacancies result. This could cause a possible default or an insurance claim. Consider utilizing existing residual receipts to offset repairs not covered by the Reserve for Replacement or other costs that are of one time occurrence. Allow reasonable amounts for inflationary increases. But before doing so assess whether the actual expense base is reasonable for the level maintenance expected during the next year and whether the project is taking reasonable efforts to control costs and is complying with the terms of the Certification in Appendix 3. If the prior period's actual

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expenses were unjustifiably excessive, adjust the prior period's actual expense before adjusting for inflation. Document this in the record.

- 3) REVIEW THE INCOME/EXPENSE ADJUSTMENTS using the guidance in the next paragraph. For each line, enter the adjustment you will allow. If your allowance significantly differs from the amount the owner entered, carefully document the reasons for the difference.

7-30. GUIDANCE FOR EVALUATING THE APPROPRIATENESS OF PROJECT EXPENSES

A. Administrative Expense

- 1) Renting Expense. Amount allowed should be reasonable related to vacancy pattern and marketing area. Weigh impact of increased expenditures on reducing vacancy. If expense increase is due to poor marketing procedures or appears to be a cushion, adjust down to

expense of similar projects. If rental expense appears low, some upward adjustments may be made if the project is experiencing high vacancy.

- 2) Salaries. To evaluate reasonableness consider:
 - a) Whether salary is for project employee or employee of agent. Recertification clerk or similar clerical employees may be, considered project employees even if work is performed in agent's office. Other project employees will normally be located on site. Where employees working in the agent's office have their salaries attributed in whole or in part to the project, owner must present documentation outlining exactly how the expense was computed.

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- b) Number of project employees. Number of employees will depend on size and condition of project and whether maintenance or other services are contracted.
 - c) Salary levels. Salaries should be commensurate with the size of the project and duties required and comparable to similar positions at other similar projects in the same area.
 - d) Identify-of-interest relationships. Where such relationships exist salary levels should be closely reviewed to ensure they do not exceed rates in arms-length relationships.
- 3) Office Supplies. Inflationary increases should be allowed if prior year amount was adequate.
- 4) Legal. If legal expenses are significant, determine reason(s): 1) large number of evictions; 2) above average fees to attorney (may be caused by lack of shopping around for adequate counsel); or 3) including legal services that should be borne by the owner

and not the project. Since the amount of legal fees should normally be within owner/agent's control (i.e., effective managers should screen prospective tenants and shop around for reasonably priced legal services), the amount allowed should not exceed the norm for similar projects in similar locations unless there was a problem unique to that project.

- 5) Auditing. Keep in mind that audit costs can vary according to the type of project and its requirements, the size of the accounting firm and the quality of the project's records and accounting systems. (See page 7-4 of Handbook 4370.4, Basic Accounting Desk Reference for HUD Loan Servicers, for a further discussion of how audit costs vary.) If this project's audit costs are high determine the cause of the higher costs. To

do so, talk with a IPA or review prior management or occupancy review reports and the IPA's comments on the Internal Control and compliance Questionnaire. If costs are out of line, require future audits to be conducted by auditors who bid on the job. NOTE: Reasonable fees for preparing any Federal, state or local tax return information require of the project may be charged against the project account and paid from project income without regard to surplus cash computations. For example, if the mortgagor entity is a partnership, the cost of preparing both the Form 1065 and the related Schedules K and K-1 may be paid from project funds. However, projects funds may not be used to pay for tax advice rendered to the mortgagor entity or its principals or for preparation of the personal returns of the project principal.

- 6) Bookkeeping Fees/Accounting Services. If a computer is used, amounts allowed should be adequate to cover the cost of such services. These charges must be approved by HUD prior to the project paying. If identity-of-interest firms are used, the cost paid by the project should not exceed what it would cost

to use a non-identity-of-interest firm.

- 7) Telephone. Allow amount for local and long distance calls related to project operations. Long distance calls from the project to the office of the management agent are chargeable to the management fee not the project.
- 8) Miscellaneous Administrative. If the MIPS Financial Flag Report indicates this expense category exceeds 5% of the subgroup require the owner to justify the need.

B. Operating and Maintenance Expense.

- 1) Supplies. Check management review reports to determine if owner/agent is shopping around for lowest possible prices and is taking advantage of

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quantity discounts and discounts for early payment of bills. Consider need for supplies and owner/agent efficiency. The budget cost of one-time repairs should be listed under project improvements. The quality of the purchase must be considered when looking at the cost. Purchasing a superior product with a longer life span at a higher cost might very well be more cost effective than purchasing a lower quality item which does not last. Cost is not the only thing you should consider when allowing an expense item.

- 2) Contracts. Consider the trade off between salary costs and contracts costs. A high level of contract repairs may indicate a need for improved maintenance capability, identify-of-interest relation with vendor, a one-time rehabilitation, or a cost-effective business decision.
- 3) Security. To determine reasonableness of expense, the Loan Specialist should consider: 1) need for expense, (i.e., is there a security problem), 2) reason for security problem, (i.e., lighting, location, layout of physical structure, or need for better project management); 3) extent to which security problems are within the control of the agent, (i.e., would stricter enforcement of lease provisions reduce security problem); 4) trade off between security services (agents) and security devices (locks, alarms, lighting, etc.); and 5) is

security expense cost effective, i.e., does security expense result in reduced turnover and vacancy.

- 4) Decorating. Determine whether new items should be budgeted under the Reserve for Replacement Account. For example, if an owner requests, a painting reserve can be established (insure monthly payments are adequate). Consider trade offs. Is project using most cost effective decorating items, i.e., would blinds be cheaper than shades in the long run? Are additional decorative items such as drapes needed to improve or maintain occupancy?

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- 5) Miscellaneous Maintenance. If amount is large, identify source and determine need and reasonableness of expense.

C. Payroll Taxes. Licenses and Insurance.

- 1) Payroll Taxes. Payroll taxes will generally be about 12-15 percent of project payroll costs. Included in this category are FICA, State and Federal unemployment and workers compensation. In some areas the high costs of workman's compensation can drive payroll taxes up to as high as 20 percent. In cases where this occurs, owners must document these costs. Known increases in rates, as well as increase in salary base, will be justification for budget increased in this expense.
- 2) Other Taxes. Identify source and assess reasonableness of expected increases and cause for increase. For example, in some states there is an intangible tax on liquid assets. The Field Office should consider assets that will be taxed during the upcoming year instead of accepting last year's estimate expense. Field Offices should be cognizant of the outcome of any tax appeals and adjust costs accordingly.
- 3) Insurance. In assessing reasonableness consider the following: a) types of coverage b) deductibles and c) claim history. Rates vary among carriers and owners should seek the lowest rates available for equivalent coverage.

D. Utility Expense. Only utilities paid by the project may be included. To determine reasonable consumption levels, review the justification from owner energy conservation survey, energy conservation plan, and other related information.

- 1) Ensure that the owner has analyzed utility rates and requested the rates most advantageous to the project. (Rates vary accordingly to consumption levels and types of usage, e.g., commercial or

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residential. Often projects can apply for either residential or commercial rates, whichever will be cheaper).

- 2) If the owner has taken the action required by the preceding paragraph above, allow rate increases which have been, or are expected to be approved and implemented. Document the rates and effective dates used in your projections.
- 3) Generally, do NOT project for increased consumption. Consumption should increase only because of severe weather. Project for consumption levels to decrease below prior periods if: The prior period had severe extremes of weather that are not expected to occur during the period the rents will be in effect; or recent energy conservation initiatives can reasonably be expected to reduce consumption levels.
- 4) THIS PARAGRAPH APPLIES ONLY TO BMIR AND SECTION 236 PROJECTS, PROJECTS THAT RECEIVE RENT SUPPLEMENT, AND PROJECTS THAT CONVERTED FROM RENT SUPPLEMENT TO SECTION B. Section 329(C) of the 1981 HCDA requires HUD to consider whether the mortgagor could control utility costs by securing more favorable utility rates or undertaking feasible, cost effective actions to increase energy efficiency or energy consumption. Section 329(C) provides that HUD may reduce budgeted utility expenses if the owner has not taken reasonable action to do so. (See 4350.1, Chapter 12 for more guidance on energy conservation measures).

E. Property Tax, Review requirements of Chapter 23, in HUD Handbook 4350.1. Allow only verified increases in rates. If taxes have decreased due to changes in State

or local tax laws, use effective rates. Consider also any changes in how the project is evaluated. Even if there is a tax rate decrease, this could be offset by a change in the appraisal process which increased the net value of the project for tax purposes.

- F. Mortgage Principal, Interest, MIP, Include principal, interest and any MIP (or service charge on HUD-held mortgages). Use the amount required by the mortgage.

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If the mortgage has been permanently modified, use the payment due under the new mortgage terms.

- G. Other Notes/Loan Payments. The owner's narrative must identify the loan terms and the purpose of the loans. (For more guidance on what loans may be charged against the project operating account, see Paragraph 2-23 (A) of Handbook 4370.1 REV-2.
- H. Reserve for Replacement. Use amount normally required by HUD, not a lesser amount that may have been approved as the result of a workout agreement. Even if the owner/agent does not request any changes in reserve for replacement deposit, this may be a good time for the Loan Specialist to check the adequacy of the account and level of deposits. If any change is required, the Field Office should insure that a HUD 9250 is sent to the mortgagee. NOTE: The Field Office should consider very carefully any increase in the Reserve for Replacement requirements for projects that are eligible or will be eligible over the next ten years to prepay their mortgages and are likely to do so. Since the reserve is an asset of the mortgagor after prepayment, this is an especially important issue in projects where the reserve is paid for by project-based subsidy (i.e. RAP, Rent Supplement or Section 8).
- I. Owner Return. Projects Owned by Non-profit Mortgagors and projects that have converted from non-profit to limited dividend (LD) ownership, must budget only for the non-profit contingency allowed in the Rent Computation Worksheet.
 - 1) This procedure for LDs is required by the regulations that govern the transfers of ownership from non-profit to profit motivated entities (see 24 CFR 265.14(a)). While these projects may NOT budget for a distribution, if surplus cash is available 24 CFR 265.15 permits the new limited dividend owners to collect a distribution of up to

6 percent of the cash contribution THEY MADE AT THE TIME OF THE TRANSFER.

- 2) For other LD projects not converted from non-profit to limited dividend. Distribution remains constant form year-to-year. Multiply the owner's

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initial equity investment by the rate of return allowed, e.g., 6,8, or 10 percent whichever is appropriate.

- J. Project Improvement Needs. Includes: 1) Non-recurring repair expense; 2) amounts needed to correct financial deficiencies; and 3) project improvements. Examples of eligible items include amounts needed to 1) restore units that have deteriorated to the point they no longer can be rented; 2) correct code violations; and 3) pay accounts payable that affect overall viability of the project (e.g., delinquent utility bills). Ineligible items include luxury improvements such as swimming pools and tennis courts. While HUD does not prescribe a specific dollar amount that may or may not be allowed, the Field Office should keep in mind the following when reviewing project improvement needs requests: 1) amount of lump sum contribution (see Item 2 below); 2) causes of problems and proposals to prevent reoccurrence (for major cost items a MIO plan is recommended); 3) management performance (check prior management review, physical inspection, audit reports); 4) impact on expenditures on rents and subsidy funds and 5) payback or potential benefits from approving the project improvements.
- 1) Do NOT allow for costs that will be paid from project improvement funds (e.g., Flexible Subsidy or TPA proceeds) or reimbursed from residual receipts or a painting, replacement, or general operating reserve.
 - 2) Owners should: Identify the total cost and scope of work and provide a written schedule for completing any capital improvements included here. List payee's name, purpose, amount and date incurred for each account payable included.
 - 3) Generally, allow amounts to clear accounts payable only on troubled projects having significant operating deficits. Allow for accounts payable only if the project's purchasing procedures are

acceptable, expenses are reasonable and management is satisfactory.

- 4) Prorate capital improvements over an appropriate period of time.

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K. Lump Sum Source. Consider the availability of all lump sum sources. If owner is unaware of lump sum sources, the Field Offices should advise the owner. Listed below are some of the most used lump sum sources to fund project improvement needs.

- 1) Section 241 HUD Insured Supplemental Loans or conventional financing for capital improvements, etc. (The debt service should be shown the Budget Worksheet under account 6830.)
- 2) Owner's loan to the project. (The terms of such a loan would have to be approved by the Field Office as repayment of the loan is to be made out of project income as an allowable line item in the rent formula, rather than from surplus cash or residential receipts.)
- 3) Advances by the owners. (See HUD Handbook 4370.2, Chapter 2, paragraph 2-11 for guidance.)
- 4) Regular Flexible Subsidy or Capitol Improvement Loans for troubled projects.
- 5) Change in ownership. (New owner equity investment can be designated for this purpose.)
- 6) Releases from the residual receipts account, if applicable or advances from the replacement reserve account, provided a HUD-approved repayment plan is included.
- 7) Energy grants from such sources at State, county, city agencies. (Field Offices should attempt to keep abreast of what types of assistance are available in the area.)
- 8) Energy loans and grants from the Department of Energy.

L. ASSESS NON-RENTAL INCOME.

- 1) ESTIMATES SHOULD BE CONSERVATIVE. If non-rental

income is significantly overstated, rent potential will not be sufficient to cover project operating costs and owner distributions. Use previous year

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figures adjusted where solid projections are not available.

- 2) Includes income from all source except: 1) apartment rents, 2) facilities and services (such as furniture, air conditioning) provided by the owner to tenants on a voluntary basis and 3) interest earned on funds invested in replacement and residual receipts reserve accounts. To assess reasonableness, compare with income from prior years.
- a) Laundry and Concession Income. Include income from laundry facilities (only if they are leased), parking space and leased commercial space in subsidized projects only (see Section 8). Make appropriate adjustments for existing commercial vacancies.
- b) Investment Income
 1. Do NOT include security deposit interest that must be paid to tenants or retained in the security deposit account and income that is retained in a painting or replacement reserve or in a residual receipts account.
 2. If the project has large reserve balances and interest income is not shown on the HUD-92410 or the owner's budget, ask the owner why the reserves are not invested. While only some projects are required to invest replacement reserves or residual receipts, all projects are encouraged to do so. Paragraph 3 of Mortgagee letter 83-24 tells you which projects must invest and how the interest must be distributed (see Appendix 11). NOTE: Interest income should not be used to reduce expenses for the purpose of granting rent increases.
 3. Other Miscellaneous Income, Do NOT include: "excess rents" collected from Section 236 tenants paying above basic rent; (exclude these amounts even if the HUD-93104, Excess

Income Report, shows the project is not required to submit excess income to HUD;)

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late charges or damage charges; (if these are collected, they will generate distributions/residual receipts or cover unexpected costs;) generally, these amounts should be relatively small. The owner must identify the purpose of any sizable amounts,

(If these amounts were not classified in accordance with IG Handbook 2000.4, require the owner to properly classify all future expenses.)

- M. Vacancy Losses on Apartments. Use the vacancy rate that was in effect at final endorsement. Normally, this will be 7 percent or 5 percent, whichever is applicable. Note: There are no vacancy factors for Section 202 projects with 100 percent Section 8.
- N. Management Fees. Include only the management fee approved in the appropriate HUD-9839, i.e., the fee that is expressed as a percentage of apartment rents/coop carrying charges collected. This applies also to the fees whose yields have been capped under paragraph 2-34, HUD Handbook 4381.5. If a fee percentage will change during the budget period, use a percentage that represents the weighted average of the fee percentages that will be in effect during the year covered by the budget.
- O. General Operating Reserve (GOR). (THIS APPLIES ONLY TO COOPERATIVES.) While GOR deposits are always a percentage of the carrying charges, the percent varies between 0 and 3 percent according to the GOR balances. To determine the GOR deposit requirements for the year covered by the budget, use the carrying charge potential now in effect and the instructions in paragraph 2-21(B)(2)(a) of Handbook 4370.1.
- P. Contingency for Non-profit Owners. A 2 percent contingency reserve is required for projects owned by non-profits and those projects once owned by non-profit but which have been sold to limited dividend partnerships.

- 7-31. Quality Control. In order to encourage uniform policy, Branch Chiefs/Supervisors should try as much as is possible to inform their staffs of: any proposed increases in property taxes, payroll taxes, and utility rates; the percentage of any inflationary increases that should be allowed for supplies, etc.; and any property tax abatements for which different types of projects are eligible. When reviewing the administrative process Supervisor/Branch Chief should consider the following.
- A. The servicer's comments should be consistent with other information - e.g., project conditions, recent servicing actions taken on this project, tenant comments, the Field Office's experience with this agent?
 - B. Are the servicer's comments dated and firmly attached to the Rent Computation Worksheet? Do the servicer's comments: explain any significant differences between the owner's and the servicer's income, expense or utility allowance estimates? Do they adequately support the servicer's projections?
 - C. Are all staff making the same projections as to increases in property taxes, utility rates, and other expenses?
 - D. Does the servicer's decision letter identify: any physical improvements for which operating funds were budgeted for in the Rent Increase Budget Worksheet; or any special conditions imposed on the owner in conjunction with approval of the rent increase request?
 - E. Evaluate the rent increase's or utility allowance adjustment's impact on any tenant-based subsidy contract? Are funds available in the current contract? If not, has action been initiated to obtain the necessary funding?

SECTION 6. COMPUTING RENT POTENTIAL AND UTILITIES

- 7-32. MAXIMUM ALLOWABLE MONTHLY RENT POTENTIAL. To compute the maximum allowable rent potential, select the

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appropriate formula from Box A of Rent Computation Worksheet and then complete Box F. In the case of Section 236 Projects, also compute the maximum allowable market rent potential and Market Rent Factor using Box G of the Rent Computation Worksheet. The first time you use the Rent Computation Worksheet for a particular project, use Appendix 4(c) to compute the monthly HUD subsidy. For subsequent rent increases, enter the monthly subsidy you computed on the prior Rent Computation Worksheet.

- 7-33. NEW MAXIMUM UNIT RENTS. (Section 236 Only.) Where a basic and market rent for each unit type must be computed, spread the monthly rent potential across the different unit types. (Rents may vary by floors if these differentiations were approved at initial endorsement. This can be changed only if HUD and the owner think it necessary.) Follow the procedures in Box H of the Rent Computation Worksheet. The Worksheet's procedures give each unit type the same percentage increase in rent. Also, compute new maximum rents, and new maximum market rents. NOTE: The dollar difference between basic rent and market rent should be the same as it was between basic and market rents at final endorsement.
- 7-34. REVIEW THE OWNER/AGENT ESTIMATE OF NON-RENTAL INCOME.
- A. Assess the reasonableness of the incomes the owner entered. Compare them with the actual amounts shown on financial statements the project has previously submitted. Note that any over-estimation of these amounts could result in a rent potential insufficient to support both operating expense and owner distributions. Enter in the column the amounts HUD will allow. If these amounts significantly differ from the owner's estimates, document why you did not accept the owner's estimates.
- B. Document your reasons for approving other than the owner's estimated expense or income. Since the Rent Increase Worksheet does not provide much space for comments, write any comments on a separate sheet of paper. COMMENTS MUST BE DATED, LABELED WITH THE FHA PROJECT NUMBER AND FIRMLY
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ATTACHED TO THE RENT COMPUTATION WORKSHEET and signed by the Servicer and LMBC.

If HUD's analysis results in a reduction of the rent level requested the owner/manager must be given an opportunity to support their request prior to HUD approving a rent level.

- 7-35. DETERMINE THE NEW UTILITY ALLOWANCES. Complete the following steps and then enter the new allowances on the Rent computation Worksheet.
- A. Review the owner's utility analysis and recommended allowances. (See Section 4, paragraph 7-24(A)) for a description of the information the owner must submit.)
 - B. Answer the following questions.
 - 1) Are the owner's comments on recent and proposed rate increases consistent with any information you have obtained from other projects, utility suppliers, news report?
 - 2) Has the owner appropriately adjusted for recent and planned rate increases?
 - 3) Has the owner appropriately adjusted consumption estimates to reflect any significant savings likely to result from recent energy conservation effort?
 - C. If the owner's analysis does not appear to support the request, discuss your concerns with the owner/agent and request additional information, if needed. KEEP IN MIND THAT BOTH UNDERESTIMATING AND OVERESTIMATING CAN HAVE AN ADVERSE IMPACT.
 - D. You should usually be able to set allowances at the levels recommended by the owner. If you approve utility allowances that deviate from those recommended by the owner, document your reasons for doing so.

SECTION 7. NOTIFICATION AND IMPLEMENTATION

7-36. NOTIFYING THE OWNER. Once a decision has been reached on a rent request, the owner should be notified by letter.

A. The letter must:

- 1) Explain the reasons for your decision to approve the increase or to deny all or part of the increase. The increase approved can be greater than what the owner requested if justified by your analysis.
- 2) Identify any project improvements for which funds were budgeted on the Rent Computation Worksheet, e.g., paint exterior of four buildings by Spring.
- 3) Confirm the amount and effective date of any revised replacement reserve deposit and complete the HUD 9250. (A recorded amendment to the regulatory agreement is not needed.) Transmit copies of the HUD 9250 to the owner, to the mortgagee and to the Management Agent.
- 4) Require owners to give tenants 30 days written notice of any increase in the tenant's rent under the terms of the lease.
- 5) Remind owners, who are subject to 24 CFR 245's tenant comment procedures, to notify tenants of HUD's decision.
- 6) Require the owner to complete parts A and F of the Form 92458 Rental Schedule reflecting unit rents not to exceed the maximum rent potential authorized, and transmit the original and one copy to HUD for signature. A signed copy will be returned to the owner.

B. Send the original letter to the owner and a copy to the Management Agent, unless the owner has requested a different distribution.

C. If the mortgage is HUD-held and delinquent, send the following to your desk officer in the Office of Multifamily Housing Management.

- 1) Your decision letter;
- 2) Rent Schedule;
- 3) Rent Computation Worksheet.

7-37. REVIEW THE OWNER'S SUBMISSION OF THE RENT SCHEDULE (FORM HUD-92458) WHEN THE PROPOSED INCREASE WON'T EXCEED THE HUD APPROVED GROSS RENT POTENTIAL.

A. Proposed rent potential is LESS than or EQUAL to the maximum allowable potential computed on the last Rent Computation Worksheet. The owner should have completed all of the Rent Schedule, except Parts F and I.

- 1) Check the accuracy of the owner's entries. Be sure: Parts D and E agree with the assumptions you made on the Rent Computation Worksheet regarding non-revenue producing space and commercial space. The effective date is correct.
- 2) Enter the Maximum Allowable Potential in Part F. (Obtain this amount from the last Rent Increase Worksheet you completed.)
- 3) Sign and date the Rent Schedule in Part I and distribute it as directed in paragraphs 7-36 (B) and (C) of this section.

7-38. IF THE PROPOSED POTENTIAL EXCEEDS THE MAXIMUM MONTHLY RENT POTENTIAL computed in the last Rent Increase Worksheet, complete columns 3 through 8 of Part A. If the owner will charge the maximum allowable rents, enter the rents computed by the owner in the Rent Increase Worksheet. (NOTE: HUD will prepare the rents by bedroom type in the case of Section 236.) Otherwise, enter the reduced rents you are authorizing the owner to charge. Complete Steps 1, 2 and 3 under the preceding paragraph.

7-39. INCREASE IMPLEMENTATION. Owners may implement HUD approved changes in rents or utility allowances only after they have: complied with tenant notice requirements; and completed any HUD-50059 or HUD 50059 Worksheet required by EXHIBIT 3-4 of Handbook 4350.3, Occupancy Requirements of Subsidized Multifamily

Housing Programs. (NOTE: These forms are not required for Section 231 or Section 202 tenants who do NOT receive tenant-based subsidies.) Owners must implement the new utility allowances for all tenants within 75 days after HUD approves them. Owners may NOT stagger implementation to coincide with tenant's annual recertifications. If a reduction in utility allowances causes the Tenant Rent to increase, the owner must give the tenant at least 30 days advance written notice of the increase.

7-40. NOTIFYING TENANTS

- A. All projects. If the rent increase or utility allowance reduction will cause an increase in the Tenant Rent, the owner must give the tenant 30 days advance written notice of the increase. The Notice must specify the new Tenant Rent and the date it will be effective.
- B. Projects subject to 24 CFR 245's Tenant Comment Procedures. The owner must notify tenants of the HUD Field Office decision. The owner's Notice must be written and must:
 - 1) Be distributed in the manner required by Section 2, paragraph 7-7.
 - 2) Tell tenants what rents and utility allowances HUD has approved, the effectiveness date, and any special conditions HUD imposed on the increase (e.g., completion dates for project improvements required of the management agent).

SECTION 8. CHARGES FOR COMMERCIAL-FACILITIES

7-41. Determining Charges. Generally, Field Offices should require owners to set commercial rents at least at levels that will cover the commercial space's share of

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project debt service and operating expenses. (Page 1, Part C of Form 92264 shows how the gross square footage is distributed between residential and commercial space.)

- A. Field Offices may authorized project owners to set commercial rents at less than break-even levels if:
 - 1. The owner has taken or is taking all reasonable steps to lease the space at market

rents or break-even rates and the reduced rates will not jeopardize the financial condition of the project.

2. The Field Office determines that the proposed use of the space will offer significant benefits to the project and would be more beneficial than other alternatives.
- B. Field Offices must NOT approve rents that are less than the market rents for comparable space unless it results in other compensatory financial benefits for the project.
- C. Owners must use either the minimum rents required by paragraph 6a or 6b in Part E of the rent schedule. If the owner is recommending a commercial rent that is less than the market rent for comparable space or less than the rent needed to cover the commercial space's share of debt service and operating expenses, the owner must:
1. Certify whether there is an identity-of-interest relationship between the operating of the commercial space and the owner, the agent or any principal of either the owner or agent; and
 2. Attach the certification of the rent schedule.
- D. If owners lease commercial space for periods in excess of 1 years, the lease should provide for any rent increase needed to keep rents at the levels required by this paragraph.

SECTION 9. CHARGES FOR FACILITIES AND SERVICES

- 7-42. Facilities and Services Subject to Charge. Owners may NOT charge separately tenants for equipment and services that are included in the rent. Part B of the Rent Schedule lists these services and equipment.
- A. Owners may offer congregate services only on terms that have been approved by HUD.
 - B. Owners may charge tenants for other services or facilities (e.g., parking see (5) below , cable TV, use of community space in the project) ONLY if

ALL of the conditions listed below are met.

1. The services, facilities and charges have been included in Part C of the most recently approved Rent Schedule.
 2. A schedule of those charges has been posted or distributed to the tenants.
 3. Use of those facilities or services is optional on the part of the tenant.
 4. If not previously authorized the charges must be approved to HUD prior to implementation.
 5. Owners can charge for parking only in unsubsidized projects where HUD previously approved it. The owner can charge for car heaters in both subsidized and unsubsidized projects in cold climates where parking spaces are so equipped.
- C. All income derived from service and facility charges must be deposited in the project operating account.

SECTION 10. PREEMPTION OF LOCAL RENT CONTROL

7-43. INTRODUCTION. For those projects that are subject to State or local Rent Control, CFR 24 Part 246 (Local Rent Control) provides for preemption as follows:

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- A. Subsidized projects are preempted entirely by the regulations in CFR 24, Part 246 - Local Rent Control.
- B. Unsubsidized projects are preempted under the regulations when the Department determines that the delay or decision of the local rent control Board, or other authority regulating rents pursuant to State or local law jeopardizes the Department's economic interest.

All requests for HUD preemption of the local Board's rent controls must be processed in accordance with the procedures discussed in this section.

7-44. PROJECTS AUTOMATICALLY PREEMPTED. This part applies to all projects with mortgages insured or held by HUD that

receive a subsidy in the form of:

- A. Interest Reduction Payment under Section 236 of National Housing Act.
- B. Below Market Interest Rates under Section 221(d)(5) of National Housing Act.
- C. Direct Loans at below-market interest rates under Section 202 of the Housing Act of 1959.
- D. Rent Supplement Payments under Section 101 of the Housing and Urban Development Act of 1965.
- E. Housing Assistance Payments under 24 CFR Part 886.
- F. Those units in a project receiving Housing Assistance Payments pursuant to a contract under Section 8 of the United States Housing Act of 1937 or Section 23 of the Act, as in effect before January 1, 1975. Units not assisted are not subject to automatic preemption under this part but are covered by paragraph 50 below.

7-45. ACTIONS OWNER MUST TAKE BEFORE SUBMITTING A FORMAL REQUEST FOR PREEXEMPTION OF UNSUBSIDIZED PROJECTS. If an owner decides to request HUD's preemption, the owner must first have asked 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. When filing the request for relief, the owner must notify the project residents 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 in the format shown at Appendix 1. 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 high-rise building in which the affected dwelling units are located. The owner must comply with all representations made in the Notice to Residents, and must give residents 30 days to review materials that will be submitted to 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. Tenant Review and Comment. Procedures outlined in Section 2 of this chapter are to be followed for tenant comment on preemption applications.

C. Notice to HUD. Immediately after distributing and posting the Notice to Residents, the owner must advise HUD that it intends to request HUD's preemption of the Board's actions. To do so, the owner must provide HUD with 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) 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 4 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-9410 for the period elapsed since the end of the project's last fiscal year.

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3) A copy of the relief application the owner submitted to the Board with supporting documentation.

4) A certified statement which provides for 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 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:

	Since end of Last FY	FY Ending __/__/____	FY ending __/__/____
Number of units vacated	_____	_____	_____
Percentage of Rent Potential lost to:			
a) Vacancies	_____ %	_____ %	_____ %

b) Collection Loss _____% _____% _____%

5) A certified statement covering known or approved rate or cost increases or decreases 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 and provide documentation for following.

a) Property tax assessment or valuation rates;

b) Utility rates;

c) Employee salaries or benefits;

d) Insurance;

e) Contract for services.

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7-46. PROCESSING AN EXEMPTION. The owner/agent shall file a request for approval of an increase in rental charges with HUD and in accordance with procedures detailed in Section 4 of this chapter. The local HUD Office will process the request in accordance with procedures detailed in this chapter. Upon receipt of authorized rents, the owners will comply with the posting requirements detailed in this chapter.

7-47. INITIAL HUD REVIEW FOR COMPLETENESS. Immediately upon receipt of the owner's submission, HUD must check the package for completeness. If the submission does not contain all of the information required by paragraph 7-45(C) of this section, HUD must request the missing information from the owner within 48 hours of review. When the submission is complete it will be held on abeyance until the owner submits a formal preemption request. If the materials omitted from the initial submission or any changes to material previously submitted were not previously made available to the project residents, the owner must give residents an additional 30 days to review these materials.

7-48. 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 request to HUD should include 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 resident's comments;
- C. The Board's decision and a statement as to the insufficiency of the funds or a statement from the owner certifying that a decision from the Board has not been received;
- D. The owner's certification that:
 - 1) The Notice to Residents required by paragraph 7-45(A) of this section was give as required.
 - 2) The owner has taken reasonable steps to assure that: (a) the substance of the Notice

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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 during 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 for the residents were considered and are being transmitted to HUD.
- E. A cover letter which is signed by the owner and includes a statement that "under the penalties and provisions of Title 18 U.S.C. Section 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."

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EVALUATING THE FORMAL REQUEST. HUD must determine if the owner's package includes all of the information required by the previous paragraph and must request any

missing materials from the owner. HUD must carefully review any residents comments, the owner's analysis of those comments and any Board decision already received. After reviewing those materials, HUD must within 10 days 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 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 the 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 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 must give the owner 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.

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

7-50. 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 residents; 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.

- 7-51. 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

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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.

SECTION 11. PROCEDURES FOR APPEALING BUDGETED
RENT INCREASE ADJUSTMENTS

- 7-52. LEVELS OF APPEAL. There are only two levels of appeal. The first level of appeal is to the HUD Field Office which issued the contested decision. This level of appeal is at least on administrative level above the level which made the final decision on the owner's original submission. (For example, if the rent adjustment letter is signed by the Loan Management Specialist then the next level of appeal is the Branch Chief). The final level of appeal is to the Director, Regional Office of Housing, for the office having jurisdiction over the property.
- 7-53. IMPLEMENTATION. Owners are permitted to delay implementation of rent changes while the HUD Field Office/Contract Administrator is processing the appeal.
- 7-54. TENANT NOTIFICATION. Rents resulting from the appeal will be implemented as follows:

- A. Projects with 100 percent Section 8

Since Section 8 tenants are not affected by the increase in gross rents, there is no need for the normal 30-day notification period accorded market

rate tenants. Owners may bill HUD for the new Section 8 rents on the next regular billing cycle under that contract. They must also comply with Handbook HUD-4350.3, Occupancy Requirements of Subsidized Multifamily Housing Programs, Exhibit 3-4 by completing a new form HUD-50059 and appropriate worksheet.

B. Projects Subject to 24 CFR 245 Tenant Comment Procedures

Owners may implement HUD approved changes in rents only after they have complied with tenant notice requirements and completed any HUD-50059 or

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equivalent worksheet required by Handbook HUD-4350.3, Exhibit 3-4. See page 7-46 of this Handbook.

C. All other Projects

If the appeal results in an increase to the Tenant Rent, the owner must give the tenant 30 days advance written notice of the increase. The Notice must specify the new Tenant Rent and date it will be effective.

7-55. INITIAL APPEAL TO FIELD OFFICE

A. ALL PROJECTS.

The appeal must be in writing and postmarked within 30 days of the date of the rental rate adjustment decision letter. It must, at a minimum, include:

- 1) A letter explaining why the owner disagrees with our decision and stating the rents being sought in the appeal
- 2) All information required in the initial submission in accordance with Chapter 7, Section 4, Paragraph 7-22 of this Handbook.

B. Projects Subject to Title 24 CFR 245's Tenant Comment Procedures

If the owner makes any material change in any documents submitted in the initial submission, it

no longer constitutes an appeal, but is now a new rent increase request and must comply with this handbook chapter.

- 7-56. FINAL APPEAL. If the owner does not agree with the initial appeal decision, the owner may submit a final appeal to the Director, Regional Office of Housing. The owner may, but is not required to, implement the rent adjustments while the final appeal is being processed. After the final decision is made, if that

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decision results in a rent increase, the tenants must be given a 30 day notice before the new rents are effective.

- A. The final appeal must be in writing and postmarked within 30 days of the date of the initial appeal decision letter.
 - B. The owner must send the Director, Regional Office of Housing, the following:
 - 1) A copy of the original decision letter, accompanied by any supporting documentation sent with the original request or involved in the original decision
 - 2) A copy letter explaining why the owner disagrees with the decision on the initial appeal
 - C. The owner must also send a copy of the letter required in Item B-2 above to the Field Office/Contract Administrator.
 - D. The owner may request a meeting with the Regional Director of Housing, but such a meeting must be requested and completed during the 30 day final appeal period.
 - E. The Regional Office will process the appeal within 30 days. The owner may, but is not required to, implement rent adjustments while the Region reviews the appeal. When the Regional Office issues a decision on the final appeal, rents must be implemented as previously described under Paragraph 7-54.
- 7-57. FURTHER APPEAL. Any decision rendered by the Regional Director of Housing will be final and

will not be subject to further appeal above that level.

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APPENDIX 1		

Subpart D -- Procedures for Requesting Approval of an Increase in Maximum Permissible Rents		
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		APPENDIX 1

Office of Assistant Secretary for Housing, HUD		245.315
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245.320	24 CFR Ch. II (4-1-92 Edition)	
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APPENDIX 2

OWNER'S CERTIFICATION AS TO COMPLIANCE WITH TENANT COMMENT
PROCEDURES IN 24 CFR 245 (FORMERLY IN 24 CFR 401)

Project Name _____ FHA or Non-Insured
Project No. _____

Acting on behalf of _____,
the Project Owner, I certify that project management has taken

ALL of the actions listed bellow.

- 1) Distributed a Notice to Tenants, in the forms and manner required by 24 CFR 245.310 and 245.410. (24 CFR 245.410 applies only if a reduction in utility allowances is proposed.)
- 2) Took reasonable steps to assure that any posted Notices remained intact and in legible form for the full comment period required by 24 CFR 245.
- 3) Made all materials submitted to justify the increase available during normal business hours in a place reasonably convenient to project residents.
- 4) Honored any resident's request to inspect those materials.
- 5) Reviewed and evaluated all comments received from project residents or their authorized representatives.
- 6) Examined all materials submitted to HUD/the State Agency in support of the rent increase request.

I also certify, that all information submitted with my rent increase request is true, correct and complete.

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, fictitious, or fraudulent statement or entry, in any matter within 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 5 years, or both.

Signed by:

Name

Title

Signature

Date

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APPENDIX 3

CERTIFICATION AS TO PURCHASING PRACTICES AND
REASONABLENESS OF EXPENSES

Project Name _____ FHA or Non-insured
Project No. _____

Acting on behalf of, _____, the
Project Owner, I certify that ALL of the following statements are
true.

- 1) The project is obtaining utilities at the lowest rates

available.

- 2) The project has received or requested any tax relief for which it is eligible and management has analyzed the project's property tax bills and appealed any assessments which appeared unreasonable.
- 3) Amounts paid to individuals or companies having an identity-of-interest with the owner or the management agent were not excess of the costs that would have been incurred in making arms-length purchases on the open market.
- 4) Management has exerted reasonable effort to take advantage of discounts and has credited the project with all discounts, rebates or commissions received with respect to purchases, service contracts and other transactions made on behalf of the project.
- 5) Management has obtained contracts, materials, supplies and services, including the preparation of the annual audit, on terms most advantageous to the project and at costs not in excess of amounts ordinarily paid for comparable contracts, materials, supplies and services in the area in which such services, supplies, or materials are furnished.
- 6) Management has solicited verbal or written cost estimates, as necessary to comply with the Paragraphs 3 through 5 above. Management has documented the reasons for accepting other than the lowest bid and will make the documentation available to HUD, upon request.

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APPENDIX 3

WARNING:

- o 18 U.S.C. 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document or writing containing any false, fictitious, or fraudulent statement or entry, in any matter within 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 5 years, or both.
- o 12 U.S.C. 1715z-4 provides in part: "Whoever, as an owner of a property which is security for a mortgage (covering multifamily housing, as defined in the regulations of the Secretary) or as a stockholder beneficial owner ... trust ... or as an officer, director or agent of any such owner (1) willfully uses or authorizes use of any part of the rents or other

funds derived from the property covered by such mortgage in violation of a regulation ... (2) willfully and knowingly uses or authorizes the use, while such mortgage is in default, of any part of the rents or expense ... shall be fined not more than \$5,000 or imprisoned not more than 3 years or both

Signed by:

_____	_____
Name	Title
_____	_____
Signature	Date

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APPENDIX 4a

RENT INCREASE BUDGET WORKSHEET-RENT INCREASE
SPREAD SHEET INSTRUCTIONS FOR COMPLETION

- A. Instructions for Rent Increase Spread Sheet:
1. Enter the following:
 - a. Project Name;
 - b. FHA #;
 - c. Management Agent - if managed by Property Management Agent;
 - d. Percentage fee or PUPM Cap. Agent certification contains authorized percent fee or PUPM Cap.
 2. If Applicable, complete the Rent Structure-current and proposed and compute monthly potential.
- B. Income and Expense Projections
1. Enter Actual Expenses for prior FY in column 1.
 2. Enter Expense from current FY to date and number of months covered. (Do not annualized) in column 2.
 3. Enter Budget Projections in column 3.
 4. Cash Requirements provides for entry of the following payments.
 - 1) Mortgage (principal)
 - 2) Reserve for Replacement
 - 3) Painting Reserve

- 4) Distribution
- 5) Other - Cash expenditures no expended.
 - a) Capital expenditures
 - b) Other Reserves

NOTE - Account codes should parallel those on the HUD-92410.

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APPENDIX 4b

SAMPLE

Owner Explanation of Income and Expense Estimates

- 6210 - Advertising and Renting Expense. This includes: 1) \$200 for periodic ads in local newspaper; and 2) the cost of credit reports on new applicants.
- 6351 - Bookkeeping Payroll and Services. Includes this project's share of centralized accounting operation. Costs are prorated over all of the 20 projects managed by our agent, Professional Management, Inc. Costs are prorated according to each project's relative volume of transactions.
- 6310 - Clerical and Occupancy Salaries. Includes one-fourth of one occupancy clerk's time. Occupancy clerk also works for XYZ Apartments and Evergreen Apartments.
- 6311 - Office Supplies. Projects a 4 percent inflationary increase over the prior year's actual expense.
- 6330 - Manager's Salary. Includes manager's salary plus contract rent on a 2-bedroom apartment. As payroll schedule shows, manager will receive a \$100 per month increase for cost-of-living and performance bonuses.
- 6340 - Legal. This represents retainer for an attorney who handles all routine project matters. This is less than last year's actual expense. Last year, a larger than usual number of evictions were required because of the former agent's failure to effectively screen applicants. That agent was removed 6 months ago.
- 6350 - Auditing. Represents the contract price for the annual audit required by Handbook 2000.4. After obtaining proposals from two other firms, we executed a contract with Jones and Smith, Inc. Their bid was \$1,200 less than the other bids and we understand that HUD Field

Offices have found their work acceptable.

- 6360 - Telephone and Answering Services. Includes local telephone service and answering service for evenings and Sunday. Allows for \$15 per month increase in

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APPENDIX 4b

answering service, effective November 1, and \$5 increase in base telephone service rate.

- 6390 - Miscellaneous Administrative. Last year's actual.
- 6450 - Electricity. Reflects 4 percent rate increase and 5 percent decrease in consumption because are described in our cover letter. NOTE: Utility company has requested a 6 percent increase. Since the Commissioner usually approves only about 2/3 of the requested rate, we are budgeting for only a 4 percent increase. We are assuming that the increase will become effective February 1, 1986, the date requested by the utility company.
- 6451 - Water. This is a 10 percent decrease over last fiscal year's actual costs. While not rate changes are expected, consumption should decline somewhat. Last year's consumption was increased by: 1) drought conditions; and 2) watering of newly seeded lawns.
- 6452 - Gas. Reflects 5 percent rate increase that has been approved by the utility commission and will become effective December 1985.
- 6453 - Sewer. Represents a 10 percent decrease from last year's actual. Sewer expense is one third of the water expense is expected to decrease for reasons discussed above.
- 6545 - Elevator. Cost of service contract with Elevators, Inc. This amount was the lowest of the three bids we obtained last Spring.
- 6510 - Janitorial and Cleaning. Last year's actual, plus 4 percent inflationary increase.
- 6570 - Motor Vehicle. Last year's actual.
- 6519 - Exterminating. Project's contract with Bug-Off provides

for one visit per month at cost of \$100 each. This amount was \$10 higher per visit than other proposals but we accepted this proposal because contractor's performance over past 3 years has been excellent.

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- 6525 - Trash Removal. Contract rate increased by \$30 to \$380/month, effective last May. This increase is partly reflected in the partial year's HUD-92410 and fully reflected in the budget. Trash is removed twice a week.

- 6530 - Security. Cost of new deadbolt locks for 15 units on Evans Street. There have been several break-ins at single family homes near that side of the project. We also have asked the police department to increase patrols in that area.

- 6537 - Grounds. Contract with Evergreen Grounds covers supplies and labor at \$6,000/year. Contract expires in December 1986.

- 6560 - Decorating and Interior Painting. Represents cost of repainting 12 units. Apartments of long-term residents are repainted every 4 years. Replacement reserves will pay for any needed drapery or carpet replacement.

- 6541 - Repairs Materials. Represents last year's repairs plus a 4 percent inflationary increase. None of the prior period's repair expenses were reimbursed out of replacement reserves; all were routine repairs.

- 6540 - Repairs Payroll. Includes; a) salary expense for two maintenance men at rates shown in the attached payroll schedule; and b) a 50 percent discount on one maintenance men's rent.

- 6710 - Property Taxes. The county has increased the assessed value by 5 percent; tax rate in unchanged. Two years ago, we successfully appealed the county's calculation of the project's assessed value. At that time, the calculation has used incorrect assumptions on income and expense levels. Since the new, increased assessed value used the revised assumptions agreed to in the appeal, we are accepting the assessed value as accurate.

- 6711 - Payroll Taxes. Budgeted at 11 percent (6.7 percent

FICA, 4.3 percent combined State and Federal unemployment) of salaries listed in the attached

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payroll schedule. Increased cost is due to cost-of-living increases in employee's base pay.

- 6719 Miscellaneous Taxes and License. Includes local licensing fees for project elevators.
- 6720 Property and Liability Insurance. Cost of an all-risk policy with Safeguard, Inc.
- 6722 Workmen Compensation. Policy covers all of agent's employees. This is project's prorated share of the total cost of the policy; the proration covers the employees listed on the attached payroll schedule.

Replacement Reserve. Includes \$15 PUM increase in monthly deposits to be implemented with this rent increase. Deposits have not been increased since project commenced occupancy in 1978. Attached is an Agreement formalizing this increase in deposits.

Project Improvements. Includes one-fourth of the cost of painting the project exterior. (Future exterior painting costs will be paid from the replacement reserve. Costs of exterior painting were considered in establishing the new deposit.)

Service Income. Average of actual income for last 2 years. Laundry machines are leased from Wash and Dry, Incorporated. Income has consistently stayed at this level.

Investment Income. \$6,000 to the \$48,000 replacement reserve (balance as of May 31, 1985) will be withdrawn for roof repairs. The remaining \$42,000 will be invested as follows:

\$34,000 in Treasury Notes at 9.24 percent. \$8,000 in insured money market account at 8.5 percent.

NOTE: All replacement reserve interest is deposited in the project operating account. State law requires that interest earned on tenant security deposits be passed through to tenants.

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Vacancy Loss. Decreased from prior year because we expect new agent to reduce tenant turnover and more aggressively market units.

Management Fees. Will request a one-half percent increase in fees, effective March 1, 1983, if new agent performs as expected. Agent has already made significant progress in turning the project around.

NOTE: Line items should reference the specific HUD-92410 Account Code. Where the increase is less than 5 percent, no justification is required. Capital expenditures should not be included in 92410 line item Budget but in other Cash expense.

If the rent increase is based on capital expenditures (non-reoccurring) a reserve analysis should be included.

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APPENDIX 4c

Original Interest Rate on Mortgage

	6.75%	7.00%	7.25%	7.50%	7.75%	8.00%	8.25%	8.50%
40	4.7021	4.9192	5.1383	5.3594	5.5821	5.8067	6.0328	6.2604
35	4.5639	4.7735	4.9851	5.1987	5.4141	5.6314	5.8054	6.0711
30	4.4152	4.6160	4.8189	5.0237	5.2303	5.4389	5.6492	5.8613
25	4.2560	4.4469	4.6397	4.8343	5.0307	5.2290	5.4290	5.6307
20	4.0864	4.2662	4.4476	4.6307	4.8155	5.0019	5.1898	5.3794

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APPENDIX 4d

Budget Worksheet
Income and Expense
Projections

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RENT COMPUTATION WORKSHEET

INSTRUCTIONS FOR COMPLETION

A. Enter the following

1. Project Name.
2. FHA Number.
3. Management Agent.
4. Management Fee - Enter percent or PUPM Fee if capped
- Information can be obtained from Management
Certification.
5. Initial Mortgage - For 236's 221(d)(3) and 202's.
6. Replacement Cost for 221(d)(4)'s, 207 and 231's.

7. Modified Mortgage - If modified indicate YES and enter Debt Service (P & I and MIP).
8. Under workout - If project under workout enter YES and workout Payment and ending date.
9. Initial Equity - Enter for 236's and 221(d)(3) only.
10. Debt Service Rate - Enter for 221(d)(3)'s, 207's, 221(d)(4)'s, 231's and 202's.

B. Compute the following

1. Box A - Substitute requested values and compute Debt Service that will be allowed
 - a) Use formula that pertains to specific section of Act.
 - b) Deregulated projects under alternative mechanism insure you enter appraised Replacement Cost.
 - c) 207's, 221(d) (4) and 231's not deregulated add 2 percent mortgage to Replacement Cost.

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2. Box B - Compute allowed return or income Reserve for 236's and 221(d)(3).
 - a) Non-profit projects transferred to limited dividend use Income Reserve computation not distribution computation.
3. Total Cash needs less Management - Box C.
 - a) Enter allowed amounts from Rent Increase Budget Worksheet less Management.
 - b) Enter Funding to Reserve that will be authorized.
 - c) Enter computed Debt Services.
 - d) Enter computed return or Income Reserve.
4. Management/Vacancy Factor, Box D - If Fee is not capped factor equals $(1 - \text{Mortgage Fee}) \times (1 - \text{Vacancy})$. If Fee is capped factor equals $(1 - \text{Vacancy})$.

5. Compute Authorized Monthly Rent Potential, Box E and F
 - a) Rent Potential (includes other Income) equals total cash (Box E) divided by Mortgage/Vacancy Factor (Box D).
 - b) Authorized Potential equals Rent Potential less other Income.
 - 1) Other Income equals commercial income and garage/parking and laundry.
 - 2) Monthly potential equals Authorized Potential divided by 12.
 - 3) Percentage Increase equals (Authorized Potential less Current Potential) divided by Current Potential.

6. Market Rent Potential, Box G - (236's only)
 - a) Compute annual HUD subsidy (See Attachment _____).

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- b) New Market Potential equals new Authorized Potential plus HUD subsidy.
 - c) Market Rent Ratio equals new Market Potential divided by new Authorized Potential.

7. Unit Rent Computations, Box H
 - a) Authorized Rent levels - for each unit type multiply current unit rent by percent increase.
 - b) Market Rate (236 projects only) multiply Authorized Rent times Market Rent Ratio.

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PROJECT NAME _____ FHA # _____ DATE _____

MANAGEMENT AGENT _____ FEE _____ (Capped Y/N)___

MORTGAGE _____ REPLACEMENT COST _____
(236, 221(d)(3) and 202) OR APPRAISED VALUE _____
(207, 221(d)(4), 231)

MODIFIED MORTGAGE (Y/N) _____ UNDER WORKOUT (Y/N) _____
(If yes) Debt service _____ If yes w/o Payment _____
(P & I & MIP)

Ending Date ___/___/___

INITIAL EQUITY _____ DEBT SERVICE RATE _____
(If NP, Total Initial Equity = 0) (Line 5d 2264A)
236 & 221(d)(3) ONLY)

BOX A DEBT SERVICE COMPUTATION

236 = Mortgage x .03034273 _____

221(d)(3) = Mortgage x Debt Service Rate _____

207/231 = Replacement Cost x Debt Service Rate _____
(Replacement Cost is new appraised cost)

202/207/221/231 = (Replacement Cost + Working Capital) x
Debt Service Rate _____
(Projects not deregulated)

Working Capital = 2 percent mortgage

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BOX B DISTRIBUTION COMPUTATION

236/221(d)(3) = Initial Equity x .06 _____
207/231/221(d)(4) = Allowance calculated in conjunction with
Debt Service

INCOME RESERVE (NON-PROFITS)

236 NP = Mortgage Payment x .06393 _____
221(d)(3) NP = Mortgage Payment x .05263 _____

BOX C RENT POTENTIAL COMPUTATION

Allowed Expenses _____
less Management (_____)

Plus

Reserves _____
Debt Service _____
Return/Net Income Reserve _____

Total Cash less Management _____

BOX D MANAGEMENT/VACANCY FACTOR

Authorized Management Fee _____ % (1)
Allowed Vacancy Percent _____ (5% or 7%)

Factor = (1 - Management Fee) x (1 - Vacancy)

(1) PUPM Cap (Y/N) _____
If yes Fee = 0
Allowed PUPM _____

BOX E

RENT POTENTIAL = Total Cash divided by Factor (Box D above)

(No PUPM Cap)

RENT POTENTIAL (PUPM Cap) = Total Cash/Factor + (PUPM Management
Fee x 12 x Number of Units)

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BOX F

1. RENT POTENTIAL _____
2. Less Other Income (_____)
3. Authorized Potential _____

4. Monthly Potential (Authorized Potential/12) _____

5. Percent Increase (Authorized Potential - Current Potential divided by Current Potential) _____

BOX G MARKET RENT POTENTIAL (236's ONLY)

Annual Subsidy (Interest Reduction Payment) _____

Authorized Annual Rent Potential (BOX F) _____

New Annual Market Rent Potential _____

Market Rent Ratio (New Annual Market Rent Potential Divided by Authorized Annual Rent Potential BOX F) _____

BOX H UNIT RENT COMPUTATIONS

Unit type

Current Unit Rent

1 + % Increase

Authorized Unit Rent

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MARKET RENT (236 ONLY)

Authorized Unit Rent

Market Ratio

New Market Rent

UTILITY ALLOWANCES

Current Utility Allowances

Approved Utility Allowances

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APPENDIX 6

REQUEST TO INCREASE MONTHLY REPLACEMENT RESERVE DEPOSITS

PROJECT NAME _____ MORTGAGEE _____

FHA OR NON-INSURED

PROJECT NUMBER _____

I hereby request an increase in the monthly deposits to the Replacement Reserve/Painting from the current amount as of _____ . Attached is the Reserve Analysis in support of this request.

Signed by:

OWNER

NAME

TITLE

SIGNATURE

DATE

AMENDMENT TO REGULATORY AGREEMENT FOR SECTION 220 AND
221(d) (4) PROJECTS (FORMS 92466)

4. (a) The owner shall not rent the units for a period of less than thirty (30) days. Commercial facilities shall be rented for such use and upon such terms as determined by the owner. Subleasing of dwelling accommodations, except for subleases of single dwelling accommodations by the tenant thereof, shall be prohibited without prior written approval of the owner and the Secretary and any lease shall so provide. Upon discovery of any unapproved sublease, owner shall immediately demand cancellation and notify the Secretary thereof.

* (For projects constructed for family use and do not have a Section 8 Contract.)

(b) Owners may charge to and receive from any tenant such amounts as from time to time may be mutually agreed upon between the tenant and the owner for any rental accommodations, facilities and/or services which may be furnished by the Owner or others to such tenant upon his request.

* (For projects constructed exclusively for handicapped tenants or who receive assistance under Section 8.)

(b) Owners may charge to and receive from any tenant such amounts as from time to time may be mutually agreed upon between the tenant and owner for accommodations. Tenants receiving Section 8 assistance shall have their rents determined by the HAP Contract. No charge shall be made, however, for facilities or services without the approval of the Secretary.

(c) In the event the project is under jurisdiction of a local rent control law or ordinance and the owner desires the Secretary to preempt those controls, the owner shall comply with applicable regulations or instructions in effect at the time of application or preemption, currently 24 CFR Part 246, Subpart B.

* Delete the paragraph which does not pertain to the project at hand. Do not delete paragraphs (a) and (b). Your choice is limited to (b).

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APPENDIX 8

REGULATORY AGREEMENT AMENDMENT FOR MORTGAGES LIMITED
DISTRIBUTION PROJECT

1. Subparagraph _____ 6(e)(1) in Form 92466, or its counterpart of the Regulatory Agreement dated _____ in connection with FHA Project No. _____ is hereby amended to read as follows:
 - (e) Make, or receive and retain, any distribution of assets or any income of any kind of the project except surplus cash and except on the following conditions:
 - (1) All distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by the law of the applicable jurisdiction; all distributions in any one fiscal year shall be limited to 1/_____ per centum on the initial equity investment, as determined by the Secretary which shall be cumulative;
2. The Regulatory Agreement is further amended by adding a new paragraph at the end of the Regulatory Agreement (i.e. #18 in Form 2466) as follows:
 - (18) Owners shall establish and maintain, in addition to the Reserve Fund for Replacements, a Residual Receipts Fund by depositing thereto, with the mortgagee, the Residual Receipts within 60 days after the end of the semi-annual or annual fiscal period within which such receipts are realized. Residual receipts shall be disbursed only at the direction of the Secretary, who shall have the power and authority to direct that the residual receipts, or any part thereof, be used for such purposes as the Secretary may determine.

The term "residual receipts" means any cash remaining at the end of a semi-annual or annual fiscal period after deducting from surplus cash the amount of distribution as limited by paragraph 6(e) hereof.

APPENDIX 9

ADDENDUM TO REGULATORY AGREEMENT AND/OR CORPORATE CHARTER FOR 207, 223(f), 608, 213 RENTAL, 234 RENTAL, 803, 810, 231(c)4 OR OWNERS OF 220 OR 221(D) (4) PROJECTS WHOSE OWNERS CHOOSE THE ALTERNATE METHOD

Paragraph _____ of the Regulatory Agreement (Corporate Charter) _____ dated _____ in connection with FHA Project No. _____ is hereby amended by adding the following:

As an alternative to the determination of rents by the Secretary based on increases in taxes and operating and maintenance costs, the owner may request and the Secretary shall approve rent levels determined by the owner, provided that:

1. The owner submits a certified appraisal of the property as a rental project.
2. The owner provided a schedule of proposed unit rents and gross potential income.
3. The owner for the initial determination shall provide an appraisal conducted by a licensed appraiser of the property (based on its use as residential rental property) which includes a rental analysis of comparable conventionally financed rental properties in the area and which shows the proposed rent. For subsequent submissions, the owner may use a qualified appraiser, a certified public accountant, or a certified member of a national housing management organization to perform the rental analysis.
4. The owner agrees that if any units in a project are assisted under the United States Housing Act of 1937, the determination of rent levels for those units receiving such assistance shall be processed in accordance with the applicable section of that Act.
5. Upon request by the owner, and provided there are no violations of this agreement, the Secretary shall approve rental rates based on the lesser of the following methods:
 - A) By using the sum of the operating costs as determined by the Secretary and the amount derived by multiplying

the debt service factor by the projects' appraised market value as residential rental property to determine the approved Gross Potential Rent; or

B) By using the comparable rents for similar conventionally financed projects to determine the Gross Potential Rents allowed.

6. The owner agrees that in the event the alternative method of maximum rent determination is requested pursuant to 24 CFR 207.19(e)(2)(ii), which results in the project being or becoming subject to local rent control and, further, that should preemption of those controls be requested, he/she must fully comply with applicable regulations in effect at the time of the request

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PART 246 -- LOCAL RENT CONTROL

24 CFR Ch. II (4-1-92 Edition)

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Office of Assistant Secretary for Housing, HUD

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24 CFR Ch. II (4-1-92 Edition)

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Office of Assistant Secretary for Housing, HUD

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246.11

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Office of Assistant Secretary for Housing, HUD

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APPENDIX 11

Mortgagee Letter 83-24

October 25, 1983

MEMORANDUM FOR: ALL APPROVED MORTGAGEES

ATTENTION: Multifamily Mortgagees

FROM: W. Calvert Brand, General Deputy Assistant Secretary

SUBJECT: Requirements for multifamily Insured Projects

1. Property Insurance Requirements
2. Increases in Replacement Reserve Deposits
3. Investment of Replacement Reserves and Residual Receipts
4. Distribution of Form HUD-9807, Request for Termination of Multifamily Mortgage Insurance

1. Clarification of Property Insurance Requirements. 24 CFR 207.260(c) requires that all projects encumbered by FHA insured mortgages must carry hazard insurance policies which meet the requirements of the Federal Housing Commissioner. Since those regulations also make mortgagees responsible for monitoring the adequacy of the coverage and for obtaining insurance when mortgagors fail to do so, several mortgage companies have asked the Department to clarify its insurance requirements for multifamily projects. That clarification follows.

Section 207.10 of the Regulations requires that multifamily projects carry a fire and extended coverage insurance policy in an amount that meets the coinsurance requirements of the insurer and is at least equal to 80 percent of the actual cash value of the project's insurable improvements and equipment. These insurance requirements apply as long as the mortgage is insured by HUD and regardless of the unpaid principal balance of the mortgage. To determine the amount of insurance required at project completion, mortgagees must use the estimate of insurable value shown in construction costs that have occurred since project completion. After the first year of project operation, HUD will consider insurance coverage to be adequate if the insurance coverage met the insurer's coinsurance requirements at the time the policy was issued and:

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- (a) the policy is endorsed with an agreed amount clause in which the insurer acknowledges the adequacy of the insurance coverage and agrees not to invoke any coinsurance penalty;
- (b) the insurer annually certifies that the insurance coverage meets its coinsurance requirements; or
- (c) the mortgagor/the insurance agent/the mortgagee annually correctly recomputes the project's insurable value by applying cost factors published in one of the nationally

recognized building cost indices and insurance coverage is increased to 8096 (or any higher percentage required by the insurer's coinsurance clause) of the revised insurable value.

If the mortgagor refuse to pay any higher premiums associated with required increases in insurance coverage, the mortgagee must pay the additional premiums and bill the mortgagor for those premiums.

2. Increase in Monthly Deposits to the Reserve for Replacements. All projects subject to the replacement reserve provisions of the revised Section 8 New Construction or Substantial Rehabilitation regulations must increase their monthly deposits to the replacement reserve annually by the percentage amount of the annual adjustment approved for that project. The revised regulations apply to all older Section 8 projects whose owners voluntarily opted to be bound by those regulations and, except as noted below, all insured and non-insured projects for which Agreements to Enter Into Housing Assistance Payments Contracts (AHAPs) were executed on or after November 5, 1979 for New Construction projects or February 20, 1980 for Substantial Rehabilitation projects. The replacement reserve requirements of the revised Section 8 regulations do not apply to previously HUD-owned projects sold pursuant to Section 886 (Subpart C). partially assisted projects, or Section 202/8 projects.

While HUD regulations do not require increases in deposits on other projects, regulatory agreements on insured and HUD-held projects do authorized HUD Field staff to approve changes in the amounts of the monthly deposits. When processing rental increases, HUD staff will analyze the adequacy of the deposits and suggest that owners increase the deposits if the increases are needed to meet replacement needs of the project.

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Whenever deposits are increased pursuant to either of the two preceding paragraphs, the Field Office will send the mortgagee fee a Form HUD-9250, Reserve for Replacements Authorization. This Form will specify the amount and effective date of the new deposit.

3. Investment of Reserves for Replacements and Residual Receipts.
 - a. Replacement Reserves. The revised Section 8 regulations require that projects subject to those

regulations invest the Reserve for Replacements. While HUD regulations do not mandate that other projects invest their Replacement Reserves, HUD encourages owners to do so as prudent investment can offset inflationary increases in repair costs and enhance a project's financial condition. If an owner elects to invest the Replacement Reserve, the Mortgagee's Certificate (Form HUD-92434) provides that the mortgagee must permit the investment. Either the mortgagee or the mortgagor may effect the investment. Mortgagors subject to the revised Section 8 regulations must retain any investment earnings in the Reserve.

Mortgagors not subject to the revised Section 8 regulations must deposit investment earnings in either the project's operating account for the Reserve for Replacements; the choice rests with the mortgagor. Investment earnings may not be distributed directly to mortgagors without regard to surplus cash considerations.

- b. Residual Receipts. In the past only projects subject to Subpart F of the revised Section 8 regulations were required to invest Residual Receipts. While the Regulatory Agreements for other projects give HUD control over the use and investment of Residual Receipt funds, in the past HUD has elected to allow those mortgagors to choose to invest or not to invest these funds. We are now changing the requirements for these projects. Effective immediately, we are requiring that all projects' Residual Receipts be invested and that any earnings on the investment be credited to the Residual Receipts account. Residual Receipts may be invested only in the accounts or securities listed under Paragraph c below. While mortgagors relinquished

control over Residual Receipts when they signed the project Regulatory Agreement, at the present time will allow the mortgagors to select among the authorized forms of investment so long as the mortgagor exercises due care and attempts to maximize earnings to the extent consistent with the project's liquidity needs.

- c. Forms of Investment. Reserves for Replacement and Residual Receipts may be invested in Treasury securities, securities issued by a Federal agency or

deposits which are insured by an agency of the Federal government. Acceptable forms of investments are listed in Paragraphs (1) through (4) below. Neither Residual Receipts nor Replacement Reserves may be invested in Repurchase Agreements (REPOS). Investments must be established so as to: (1) permit the mortgagee to convert the investment to cash at any time; and (2) provide that the investments will at all times be under the control of the mortgagee.

- (1) Direct Obligations of the Federal Government Backed by the Full Faith and Credit of the United States. These include U.S. Treasury Bills, Notes and Bonds.
- (2) Obligations of Federal Government Agencies. These include, for example, GNMA Mortgage Backed Securities, GNMA Participation Bonds and Farm Credit Administration issues.
- (3) Demand and Savings Deposits. Demand and savings deposits at commercial banks, mutual savings and loan associations and credit unions are permitted, provided that the entire deposit is insured by the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Share Insurance Fund (NCUSIF), or the Federal Savings and Loan Insurance Corporations (FSLIC).
- (4) Insured Money Market Deposit Accounts. Investment in money market accounts is permitted, provided that the account is
insured by one of the Federal agencies
identified in Subparagraph 3c(3) above.

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- d. Choosing Among Available Forms of Investment. Except as noted below, the mortgagor has the right to determine which of the investment discussed in Paragraph 3c will be used and a mortgagee may not restrict the mortgagor's choice. A mortgagor may authorize a lender to select the form of investment, if the lender is willing to accept that responsibility. If a mortgagor retains the authority to choose among authorized forms of investment, the mortgagee may require the mortgagor to provide written directions as to the type of investment desired. A mortgagee may refuse to honor mortgagor's request for a specific

investment only if:

- (1) the mortgagee determines that the mortgagor's choice of investment will significantly increase the lender's cost of administering the reserve, and the mortgagee identifies another investment which offers liquidity, security and yield equal to or better than that proposed by the mortgagor; or
- (2) the proposed investment does not meet the criteria discussed in Paragraph 3.c. above.

e. Mortgagee Fees. The mortgagee may charge a fee for administering invested residual receipts or replacement reserves if the fee is acceptable to the mortgagor. If there is an identity-of-interest between the mortgagee and either the mortgagor or its management agent, the mortgagor must assure that such fees do not exceed the amounts commonly charged when there is no identity-of-interest between the mortgagee and mortgagor. The mortgagor must disclose any such fees in the Replacement Reserve or Residual Receipts supporting schedules to the annual financial statement.

4. Distribution of Form HUD-9807, Request for Termination of Multifamily Mortgage Insurance. The mortgagee is required to submit Form HUD-9807 when the mortgage is prepaid or the mortgagor and mortgagee agree to terminate the mortgage insurance. Instructions printed on Form HUD-9807 direct mortgagees to mail the form only to HUD Headquarters. To increase the accuracy of Field Office portfolio listings and address lists, we are now asking that mortgagees mail all HUD-9807 requests to both HUD Headquarters and the HUD Field

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Office having jurisdiction over the project in question. The Field Office's copy should be sent to the attention of the Housing Division Director.

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APPENDIX 11

March 28, 1989

TO: ALL APPROVED MORTGAGEES/ATTENTION: Multifamily Mortgagees

FROM: James E. Schoenberger, General Deputy Assistant
Secretary for Housing

SUBJECT: Investment of Replacement Reserves and Residual
Receipts in Tax-Exempt Securities

HUD encourages, and in many programs requires, owners to invest Replacement Reserve and Residual Receipts Funds in order to offset inflationary increases in repairs and replacement costs and to enhance a project's financial condition.

Mortgagee Letter 83-24 permitted the investment of Replacement Reserves and Residual Receipts funds only in Treasury securities, securities issued by a Federal agency, or deposits which are insured by an agency of the Federal government. While HUD encourages and often requires the investment of these funds, provisions in the Tax reform Act of 1986 may prohibit mortgagors from offsetting taxable interest earnings on these accounts with passive losses from a project. Thus, there may be a disincentive to invest in taxable securities/accounts.

For this reason, we have reevaluated Mortgagee Letter 83-24 and have attempted to identify a tax-exempt security or securities which could be used as an investment of Replacement Reserve and Residual Receipts funds. We have sought to identify secure, liquid instruments, for which the return of principal and payment of interest are assured, to the maximum possible extent.

Effective immediately, in addition to the investments currently permitted in Mortgagee Letter 83-24, HUD will permit the purchase of the following tax-exempt securities:

1. AAA rated GNMA collateralized tax-exempt bonds
2. AAA rated pre-refunded bonds. These are bonds that originally may have been insured as general obligation or revenue bonds but are now secured, until the call date or maturity, by an "escrow fund" consisting entirely of direct U.S. government obligations that are sufficient for paying the bondholders.

NOTES OF CAUTION

1. In order to assure that required amounts have been paid into the Replacement Reserves and Residual Receipts accounts, the actual costs (which in many cases may not be the face value) of these and other approved securities, must be shown on the project books. In addition, details of these transactions should be disclosed in the footnotes to the Annual Financial Statement.
2. When HUD approves disbursements from Replacement Reserves or Residual Receipts funds and the funds are invested in these and/or other permitted securities, mortgagees must, to the extent that reserves are available, assure that securities are sold in an amount which results in proceeds sufficient to cover the disbursement.
3. Since the sale or redemption of these securities, as well as others already permitted, may result in cash proceeds of less than the amount invested, Chapter 4, Section 10, paragraphs 1(c)(3) of Handbook 4350.1 applies.
4. It is incumbent upon owners and managers, when making decisions on the purchase of these and other approved securities, to carefully consider the potential losses which may arise from sale or redemption of the securities.
5. Since HUD is limiting the purchase of these securities to those that are AAA rated, HUD will not permit, as an operating cost, fees for a Financial Advisor to assist in selecting such securities for investment.

Questions on the above may be addressed to your local HUD Field Office or the Office of Multifamily Housing Management, Planning and Procedures Division, phone (202) 426-3944. This is not a toll free number.

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APPENDIX 12

Suggested form of letter for use with appropriate modifications for type of project and situation by Housing Management Division Directors in accordance with Section 4, Paragraph 8(c)(3).

Certified Mail
Return Receipt Requested

According to our records, you have received a previous

letter from the Office of Finance and Accounting, Department of Housing and Urban Development, requesting submission of page 1 of Form (HUD-93104) (HUD-93104A), Monthly Report of excess Income, and the excess income collected, if any, for the month(s) of..... This report is required to be submitted monthly from all projects even in cases where there is no excess income.

You are hereby notified that, unless the requested page 1 of Form (HUD-93104)(HUD-93104A), Monthly Report of Excess Income, and any excess income collected for the month(s) of.....are remitted to the Office of Finance and Accounting, Department of Housing and Urban Development, Attention: Billing and Receivable Division, 451 7th Street, S.W., Washington, D.C. 20410, within thirty (30) days of the date of this letter, the interest reduction payments to the mortgagee on behalf of this project, beginning with the next payment falling due, will be suspended or terminated in accordance with paragraph.....of the (Regulatory Agreement) (Interest Reduction Contract).

Should such suspension occur, you will be liable to the mortgagee for the full amount of the next mortgage payment falling due. Your failure to make the full mortgage payment within the usual time limit may result in a default under the terms of the Mortgage which will be handed in accordance with regular default procedures. (This last sentence is applicable to insured and HUD-held projects only.)

You are strongly urged to contact this office immediately if there are any factors beyond your control or of an unusual nature which will prevent your immediate compliance with the above requirements.

(To be signed by Housing
Management Division Director)

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APPENDIX 13

Rent Schedule
Low Rent Housing

HUD-92458 (2-89)
HB 4566.2

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APPENDIX 14 a

CONFESSION OF JUDGMENT NOTE

Amount:

Date:

_____, Maker of this Note, promises to pay to the order of the Secretary of Housing and Urban Development (HUD), 451 Seventh Street, S.W., Washington, D.C. 20410, the sum of _____ Dollars (\$ _____), in monthly installments of \$ _____ starting on _____, 19 ____, plus one final installment of \$ _____ on _____, 19 ____, the due date of this Note.

Holder (HUD), its successors or assigns) may collect a late charge of 10% on any installment that is at least five days past due.

Failure to pay an installment within five days after the date the installment is due shall constitute a default, and upon such default Holder may, without notice, declare the unpaid balance to be immediately due and payable.

This Note is secured by an Excess Rentals Repayment Agreement, a breach of which shall constitute a default under this Note.

In the event of default as specified above, Maker hereby appoints HUD as its attorney, which appointment shall be irrevocable, with the power to confess judgment against Maker in

any court of law having jurisdiction.

Should payment not be made by the due date, Maker agrees to pay interest at the rate of _____ percent (%) per year on the amount past due until paid.

Maker severally waives demand, notice and protest, and any defense due to extension of time or other indulgence by Holder, or to any substitution or release of collateral.

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APPENDIX 14a

Maker agrees to pay reasonable costs of collection, including attorney fees', whether or not judgment is entered on this Note.

Name (typed or printed)

Address

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APPENDIX 14 b

FHA Project No.:

Project name:

Project location:

EXCESS RENTALS REPAYMENT AGREEMENT

This Agreement is entered into this _____ day of _____ 19 by and between _____, hereafter referred to as "Debtor", and the Secretary of Housing and Urban Development, his successors and assigns, hereafter referred to as "HUD" Debtor's address is _____ HUD's address is 451 Seventh Street, S.W., Washington, D.C. 20410.

RECITALS

Debtor is the owner of the above-identified project, which is subject to a first mortgage (deed of trust) held by _____

Pursuant to subsection 236(g) of the National Housing Act, 12 U.S.C. 1715z-1(g), and by the terms of a Regulatory Agreement or other contractual document entered into by Debtor with HUD, Debtor is obligated to accumulate and periodically pay to HUD all rental charges collected in excess of the basic rental charges.

HUD has made demand for payment of the excess rental charges in the amount of \$_____, and the undersigned warrants to HUD that the Debtor, as of the date of this Agreement, owes HUD that amount but asserts that it is unable to pay that amount in a lump sum. The undersigned warrants further that he/she has been authorized to enter into this Agreement and to execute the Confession of Judgment Note secured by this Agreement (the "Note") in the above amount on behalf of the Debtor.

HUD has agreed to accept periodic payments of said amount, with interest, as included in the Note.

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APPENDIX 14b

UNDERTAKING

Therefore, in consideration of Debtor's execution of this Agreement and of the Note, which bears interest at the rate of _____ percent (%) per year, HUD agrees to forbear from pursuing its legal and equitable remedies against Debtor, but only for so long as Debtor makes timely payment under the terms of the Note.

Debtor shall have _____ months to pay its debt, starting from the first day of the first month after full execution of this Agreement. Any unpaid principal balance of the Note, plus all accrued interest, remaining unpaid at the end of such period will become due and payable immediately as set forth in the Note.

Debtor agrees to submit to HUD Forms HUD 93104 for the months of _____, which Debtor admits have not yet been submitted and are late.

No delay or omission of HUD to exercise any right to which it might be entitled shall be construed to be a waiver of any such right, and every right, power and remedy enuring to HUD in equity, by law or contract may be exercised from time to time and as often as may be deemed necessary by HUD.

This Agreement is assignable by HUD but may be amended only by a written instrument executed by Debtor and by HUD or its assignee.

This Agreement will be executed in three counterparts, each of which shall be deemed an original. Debtor will receive one counterpart, and HUD will receive two.

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APPENDIX 14b

In testimony whereof, Debtor and HUD have executed this agreement effective the date first above written.

Debtor

By: _____
Secretary of Housing and
Urban Development

Witness:

By: _____
Director, Housing
Management Division

If repayment period exceeds 12 months:

By: _____
Regional Director
for Housing

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