HUD UPDATES 2016
Table of contents

Disparate Impact 1-8
REAC/MOR 9-11
PACE 11-12
Resident Participation 13

References - More detail
MOR - Resident checklist
Preservation Options for Section 236 Properties
FAQs on new Utility Allowance
HUD Notice on Tenant Participation
HUD Guidelines on use of Criminal Records
HUD Notice for new Benchmarking Rules
Proposed new FHA rules for individual unit mortgage (they will apply to share loans)
Disparate Impact
Criminal Records
And
Fair Housing
Disparate Impact under the Fair Housing Act

In June of 2015 the US Supreme Court upheld "Disparate Impact" as a form of discrimination under the Fair Housing Act.

What is Disparate Impact?

(HUD Definition) A practice that actually or predictably results in a disparate impact on a group of persons or creates, increases, reinforces, or perpetuates segregated housing patterns because of race, color, religion, sex handicap, familial status or national origin.

This rule has complicated proof issues.

Proofing disparate impact

- Need not to show intent for disparate impact claims
- Claims based on statistics that suggest a housing policy has a discriminatory effect on a protected class.
- Disparate impact is used to attack policies or practices that are neutral on their face but that have allegedly disproportionate impact on minorities.
- Disparate impact may expose cooperatives to liability for otherwise "normal" operations and policies.

Crime/drug credit screening policies may have a disproportionate effect.

Three Step Burden-shifting approach:

- The plaintiff (or charging party) must make a prima facie (First Look) showing of either a disparate impact or segregative effect.
- If the discriminatory effect is shown, the burden of proof shifts to the respondent to show "Legally sufficient justification."
- If the respondent satisfies the burden, then the charging party/plaintiff may still establish liability by proving that these substantial, legitimate, nondiscriminatory interests could be served by another practice that has a less discriminatory effect.
The future:

- Expect swift increase in the number of cases
- Effectively, expands number of "pseudo-protected classes" (high risk borrowers, convicted felons, persons with non-wage income)
- Lower courts will have to wrestle with the details.

Future kind of challenges

1. Residency preference
2. Drug/crime screening policies
3. Membership decisions based on source or type of income
4. Credit screening
5. House rules

What to do now:

- Review new/existing policies or practices
- Be cautious about rules that focus on specific groups (Like restricting children's activities)
- Document the what and why on occupancy requirements, preferences and house rules.
The Convict Next Door: New Rules on Convictions affect all Cooperatives.

By

Randall A. Pentiuk, Esq.

and

Kerry L. Morgan, Esq.

On April 4, 2016, the Office of General Counsel for the U.S. Department of Housing and Urban Development (HUD) issued a Guidance on the application of the Fair Housing Act to Cooperatives and other housing providers. The Guidance notes that a greater percentage of African Americans and Latinos than whites have criminal records. The refusal to rent or sell to persons with criminal records may therefore have a disparate impact on race and perhaps national origin.

While the Act does not prohibit housing providers from appropriately considering criminal history information when making housing decisions, arbitrary and overbroad criminal history-related bans are likely to lack a legally sufficient justification. Thus, a discriminatory effect resulting from a policy or practice that denies housing to anyone with a prior arrest or any kind of criminal conviction cannot be justified, and therefore such practices likely violate HUD rules under the Fair Housing Act.

What does this mean for Cooperative Boards and management companies? It means you're your Board need to reevaluate its screening and selection policies. The Guidance applies to all Cooperatives, whether or not they receive federal funds or report to HUD.

The take-away from this development is that Cooperative policies that exclude persons based on criminal history must be tailored to address such factors as the type of the crime and the length of time since conviction. Even then, such policies will be subject to review if challenged by HUD or in court.

Here are some suggestions for your Cooperative Board and management company to start considering. Your Application Forms will most likely have to be revised and a separate policy adopted. Your Cooperative Attorney should also be asked to review your current policy. Of course, any policy being considered for adoption should be also reviewed by your Attorney.

Screening Process

• The Cooperative will conduct a criminal background check on each adult member of an applicant household. An adult means a person 18 or older or a person convicted of a crime as an adult under federal, state, or tribal law.
• On the application form, the Cooperative will request the applicant to identify felony convictions and provide an explanation of any mitigating circumstances, including, but not limited to: (1) the seriousness of the criminal activity; (2) the relationship between the criminal activity and the safety and security of residents, Cooperative staff, or property; (3) the length of time since the offense; (4) the age of the household member at the time of the offense; (5) evidence of rehabilitation, such as employment, participation in a job training program, education, participation in a drug or alcohol treatment program, or recommendations from a parole or probation officer, employer, teacher, clergy, social worker, or community leader; and (6) the effect a denial of admission will have on the household and the community.

• If the criminal background check reveals negative information about a household member, and the Cooperative proposes to deny membership due to the negative information, the Cooperative will make a written independent analysis of the above mitigating factors prior to making a decision on the application. The written analysis shall be made part of the applicant's file. The Cooperative shall thereafter send the subject of the record (and the applicant, if different) a copy of the criminal record, and the cooperative's written analysis of the factors, and provide the applicant an opportunity to dispute the accuracy and relevance of the record and analysis.

• If the applicant does not contact the Cooperative to dispute the criminal record within 14 days, the Cooperative will send a written notice of ineligibility to the applicant and deny membership. The notice of denial will state the specific reason(s) for denial.

Eligibility Criteria

• The Cooperative will deny admission to a household if a member is subject to a lifetime registration requirement under a state sex offender registration program.

• The Cooperative will deny admission to a household if a member has been convicted of manufacturing or producing methamphetamine on the premises of federally-assisted housing.

• The Cooperative will deny admission to a household if a member has been evicted from federally-assisted housing for drug-related criminal activity within the past three years, unless the member has successfully completed a supervised drug rehabilitation program or the circumstances leading to the eviction no longer exist.

• The Cooperative will not consider unproven allegations or arrests that did not result in convictions as evidence of criminal activity. In addition, the Cooperative will not consider expunged/purged/sealed convictions as evidence of criminal activity.

• The Cooperative will not consider juvenile adjudications that do not qualify as convictions under state law as evidence of criminal activity.

• If the applicant's past criminal activity was related to his or her disability, the Cooperative will provide a reasonable accommodation if necessary.
• If the applicant's past criminal activity was the consequence of acts of domestic violence, dating violence, or stalking against him or her, the Cooperative will not deny admission.

• If the Cooperative proposes to deny admission to a household based on the past criminal activity of a member, the Cooperative will provide the household an opportunity to exclude the member and obtain admission.
Evaluating Criminal Records? Follow 7 PHA Best Practices

Key: Give weight to conviction-not arrest-records

The new Notice H 2015-10 lays down the ground rules for what you should and should not consider when making admission, assistance and tenancy decisions regarding criminal activity and arrests - but how can you translate these rules into real policies and daily practices?

Thankfully, the U.S. Department of Housing and Urban Development (HUD) provides the following examples of "best practices:"

1. **Look at conviction records only.** Many public housing agencies (PHAs) have adopted written admission policies that limit their criminal record screening to assessments of conviction records, HUD says. This way, agencies don't make the mistake of basing a decision on unproven criminal allegations.

2. **Allow applicants to present mitigating circumstances.** In screening for criminal activity, some PHAs allow public housing and Housing Choice Voucher (HCV) applicants to address and present mitigating circumstances regarding their criminal background before admission decisions, HUD notes.

3. **Limit your lookback period.** Some PHAs limit what criminal conduct they consider during the screening process based on when the conduct occurred and/or the type of conduct. For example, when screening HCV applicants, one PHA adopted a 12-month lookback period for drug-related offenses and a 24-month lookback period for violent and other criminal activity that threatens other residents' health, safety, or right to peaceful enjoyment of the premises.

4. **Consider specific factors.** You could adopt admission policies that spell out specific evaluation factors regarding an individual's criminal record, including:
   - Whether the applicant's offense bears a relationship to the safety and security of other residents;
   - The level of violence, if any, of the offense for which the applicant was convicted;
   - The length of time since the conviction;
   - The number of convictions on the applicant's criminal record;
   - Whether the applicant was under the influence of alcohol or illegal drugs at the time of the offense, if the applicant is now in recovery for an addiction; and
   - Any rehabilitation efforts that the applicant has undertaken since the time of conviction.

5. **Integrate supportive services.** Some PHAs have implemented pilot programs that allow formerly incarcerated individuals to add onto a family member's voucher if all involved agree to participate in the program and the individual agrees to six months to one year of supportive services with nonprofit partners.

6. **Hire on expertise.** One PHA hired an "offender reentry housing specialist" who collaborates with a formerly incarcerated individual's parole officer, landlord, and treatment provider to ensure successful reentry into the community, HUD notes.

7. **Consider specific circumstances before eviction.** You may adopt policies that list the circumstances you'll consider prior to terminating a lease based on criminal activity, including:
   - The seriousness of the offending action, especially regarding how it would affect other residents;
   - The extent of the leaseholder's or other household member's culpability or participation in the offending action, including whether the culpable member is a minor, a person with disabilities, or a victim of domestic violence, dating violence, sexual assault or stalking;
   - The effects that the eviction will have on other family members who were not involved in the offending action or failure to act;
   - The effect on the community of the termination, or of the PHA's failure to terminate the tenancy;
   - The effect on the integrity of the public housing program;
   - The demand for housing by eligible families who will adhere to lease responsibilities;
   - The extent to which the leaseholder has shown personal responsibility and whether he has taken all reasonable steps to prevent or mitigate the offending action; and
   - The length of time since the violation occurred, the family's recent history, and the likelihood of favorable conduct in the future.

**Bottom line:** If your tenant selection plan and screening criteria indicate "you would deny an applicant based solely on an arrest record (versus a conviction), you should modify the screening criteria," advises Mary Ross, president of Ross Business Development in Marietta, GA. Likewise, if your House Rules indicate that you would terminate assistance and/or tenancy because of an arrest (versus a conviction), you need to modify your House Rules.

**Resource:** The Notice recommends that you read the Sargent Shriver National Center on Poverty Law's May 2015 report, "When Discretion Means Denial: A National Perspective on Criminal Records Barriers to Federally Subsidized Housing." You can access this report at http://povertylaw.org/wdmd.
**Service Animal vs. Assistance Animal**

**ADA**

Service Animal
- Only dogs that are trained to do work or perform tasks for the benefit of a disabled person
- Specifically excludes emotional animals
- Not treated as a reasonable accommodation request
- Need only to meet the definition of a service animal
- Only two inquiries permitted:
  - Is this a service animal that is required because of a disability?
  - What work/tasks has the animal been trained to perform?
- May require proof of training

**FHA/SECTION 504**

Assistance Animal
- Any animal that works, provides assistance or performs tasks for the benefit of a disabled person, or provides emotional support that generally ameliorates the effects of a person's disability
- No requirement for training
- Treated as a reasonable accommodation request
- Use general principles applicable to all reasonable accommodation requests
- Upon a request, must consider:
  - Is the person who needs the animal disabled?
  - Does the person requesting the animal have a disability-related need for an assistance animal?
- Answers to questions will determine whether reasonable accommodation must be made

**When All Three Laws Apply**

Use ADA definition of service animal. If the animal meets the ADA test, inquiry ends.

If animal does not meet ADA, apply FHA and Section 504 reasonable accommodation principles.
HUD issues new UPCS inspector protocol concerning Bed Bug Infestations

HUD is amending the inspection protocol requirements to be followed by all Uniform Physical Condition Standards (UPCS) inspectors who conduct physical inspections of HUD-assisted and -insured properties. In 2010, HUD issued Inspector Notice 2010-01 establishing requirements when an inspector is informed of bed bugs at a site that is being inspected. Those requirements addressed reporting of bed bugs and the conduct of inspections. The new notice amends the requirements and now requires inspectors to enter all units in which bed bugs are reported.

Researchers at HUD’s Office of Lead Hazard Control and Healthy Homes have concluded that the likelihood of bed bug transfer to an inspector from an infested unit is remote. Bed bugs are nocturnal and usually hide on upholstered furniture or beds. They are not very active and do not quickly respond to a human host during the day. Furthermore, HUD concludes that an individual’s movement in a unit during inspection makes it even more difficult for bed bugs to find a host. Therefore, the threat to inspectors is infinitesimally low for bed bugs to be carried out on the inspector following a routine inspection.

Based on this research, effective Feb. 1, HUD is requiring the inspection of all units in the sample generated by the UPCS software, including those reported to have bed bugs.

What to Expect at Inspection Time?

Inspections are to be performed during the site’s normal business hours on Monday through Friday. Inspections may begin at any time during normal business hours on which the site representative and inspector mutually agree. A morning inspection usually begins no later than 9 a.m. and an afternoon inspection usually begins by 1 p.m. Inspectors must conclude the day’s inspections before the end of the site’s business day. And inspection of site and building exteriors must be concluded during daylight hours [REAC Compilation Bulletin Rapid 4.0].

Before beginning the inspection, when the inspector meets with the site representative, the inspector will ask if there have been any reports of bed bugs in any units. The inspector will record the answer in the "Comments" field under the "Property Information" tab of the Data Collection Device (DCD) software.

If bed bugs have been reported, the inspector will call REACs technical assistance center (TAC) to report the presence and location of the bed bugs and obtain a reference number. Then the inspector will write the reference number and identify the building(s) and unit(s) with bed bugs in the comments field.

Inspectors are required to enter all units reported to have bed bugs that show up in the sample units generated by the UPCS software and conduct the normal REAC inspection. The presence and treatment of bed bugs on a site won’t be scored in the UPCS inspection.

If bed bugs are discovered after the start of the inspection, the inspector will call TAC and report the presence of bed bugs and the building/unit location. TAC will issue a reference number that the inspector will record in the comments section of the DCD software.

If you or the site representative refuses entry to units reported to have bed bugs, the inspector will call TAC immediately and mark the inspection as unsuccessful.
Hold REAC Inspectors To These New ‘Business Rules'

**Say goodbye to 'shadow' inspectors during REAC inspections**

Along with the newly released UPCS Guidance & Protocol Clarification document, the U.S. Department of Housing and Urban Development (HUD) has also created new rules for Real Estate Assessment Center (REAC) inspectors to follow while inspecting your property. Here's what you should expect from the new requirements.

Earlier this year, HUD issued the new REAC Inspection/Inspector Administration Business Rules, containing basic rules of behavior and a Code of Conduct. According to the new Code of Conduct, inspectors must:

- Display their REAC-issued photo ID card throughout the entire inspection;
- Respect resident privacy (i.e., inspectors cannot attempt to open a closed door in a resident, but instead must defer to the property representative to open the door);
- Comply with reasonable requests from residents and project representatives during the inspection;
- Defer all questions from residents regarding the property to the property representative accompanying the inspector; and
- Defer all questions from third parties about the inspection or its results to the property owner or representative.

Conversely, the Code of Conduct states that inspectors must not:

- Give their opinions or comment about the nature or condition of the property or residents;
- Make representations or promises to residents, property representatives or staff that items will be repaired based on the inspection's results;
- Attend or participate in an inspection that another HUD-certified UPCS inspector is conducting while providing independent consulting services of any kind on behalf of the property owner or representative;
- Allow or bring along any unauthorized person (including family, friends, or UPCS certified/decertified inspectors) to a UPCS inspection;
- Use any facility on a property, property owner's office, housing agency office, or HUD field office to conduct personal business;
- Use profanity or other offensive language prior to, during, or after an inspection;
- Engage in fraudulent activities (such as, but not limited to, falsifying an inspection);
- Conduct an inspection under the influence of alcohol or drugs;
- Smoke anywhere on a property;
- Threaten, verbally or in writing, residents, inspection participants, property representatives, or any other individual with whom the inspector comes in contact;
- Carry a firearm or weapon of any kind, or any other object that could be construed as a weapon, on a property;
- Commit theft or intentional damage to property;
- Cancel an inspection due to a QA review;
- Threaten or engage in violence against any person while conducting an inspection; and
- Engage in sexual misconduct or any other type of unwanted conduct.
<table>
<thead>
<tr>
<th>Risk Classification: Troubled</th>
<th>Last MOR: Unsatisfactory</th>
<th>Last MOR: Below Average</th>
<th>Last MOR: Satisfactory</th>
<th>Last MOR: Above Average</th>
<th>Last MOR: Superior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 12 months</td>
<td>Within 12 months</td>
<td>Within 24 months</td>
<td>Within 24 months</td>
<td>Within 24 months</td>
<td>Within 24 months</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Classification: Potentially Troubled</th>
<th>Last MOR: Unsatisfactory</th>
<th>Last MOR: Below Average</th>
<th>Last MOR: Satisfactory</th>
<th>Last MOR: Above Average</th>
<th>Last MOR: Superior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 12 months</td>
<td>Within 12 months</td>
<td>Within 24 months</td>
<td>Within 36 months</td>
<td>Within 36 months</td>
<td>Within 36 months</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Classification: No-I/I Troubled</th>
<th>Last MOR: Unsatisfactory</th>
<th>Last MOR: Below Average</th>
<th>Last MOR: Satisfactory</th>
<th>Last MOR: Above Average</th>
<th>Last MOR: Superior</th>
</tr>
</thead>
<tbody>
<tr>
<td>Within 12 months</td>
<td>Within 12 months</td>
<td>Within 36 months</td>
<td>Within 36 months</td>
<td>Within 36 months</td>
<td>Within 36 months</td>
</tr>
</tbody>
</table>
PACE
WASHINGTON - In order to enable homeowners seeking clean energy technologies in their homes to leverage a range of financing options, the Federal Housing Administration (FHA) today announced guidance that makes clear the circumstances under which it will insure mortgages on properties that include Property Assessed Clean Energy (PACE) assessments. FHA will now approve purchase and refinance mortgage applications in states that treat PACE obligations as special assessments similar to property taxes. Read more about FHA's new guidance.

FHA's action is part of a larger Administration effort to expand access to clean energy technologies to every American family with the option to transition to solar energy and make improvements to their homes to cut their energy bills. Read more.

PACE is showing promise as an effective way to finance energy efficiency, renewable energy, water conservation, and other resilience upgrades to homes, including new heating and cooling systems, lighting improvements, solar panels, water pumps, and insulation. PACE pays the costs for such enhancements and is repaid through an assessment added to the property's tax bill. State and local governments sponsor PACE financing to encourage energy efficiency, solar energy deployment, advance resilience, create jobs, promote economic development, and protect the environment.

"Today, we're seizing the opportunity to shape a cleaner and more sustainable nation, "said Ed Golding, HUD Principal Deputy Assistant Secretary for Housing. "Using PACE, families will be able to make their homes more energy efficient and sustainable in the long run, while still keeping their costs affordable today. As PACE programs continue to develop across the nation, the positive impact on families, jobs, and the environment will only grow."

-11-
FHA's new guidance addresses PACE programs where the PACE obligation is treated like a property tax and does not allow the full obligation to have priority or 'prime' status over the FHA mortgage lien. By law, FHA cannot accept a first lien PACE structure (except for past due amounts as is the case for all tax assessments).

In accordance with existing guidance, lenders will be responsible for escrowing PACE payments as they would property taxes. In addition, purchasers of homes with existing PACE obligations will be responsible for any unpaid balance of the obligation.

The guidance protects FHA from risk in a variety of ways. Lenders must escrow payments for PACE assessment so FHA should never be at risk of losing collateral in a tax sale. FHA is also protected as its appraisal policy requires that appraisals take into account the PACE assessment and the value of the improvements.

The Department of Energy is updating its Best Practices Guidelines for Residential PACE Financing, which may be used by states and counties to align with their consumer protection goals.

To qualify for FHA insurance on mortgages for properties that include PACE assessments, lenders must determine that the following requirements have been met under the laws in the state where the property is located:

1. The PACE obligation must be collected (escrowed) and secured by the creditor in the same manner as a special assessment against the property.

2. The PACE obligation cannot accelerate -namely, the entire amount of the obligation cannot become due in the event of delinquency after endorsement of the FHA-insured mortgage. The property may be subject to an enforceable claim or lien that is superior to the FHA-insured mortgage but only for the delinquent portion of the PACE obligation.

3. There are no terms or conditions that limit the transfer of the property to a new homeowner.

4. The existence of a PACE obligation on a property is readily apparent to mortgagees, appraisers, borrowers and other parties to an FHA-insured mortgage transaction, and information on PACE obligations must be readily available for review in the public records where the property is located.

5. In the event of the sale, including a foreclosure sale, of the property with outstanding PACE financing, the PACE assessment remains with the property. In cases of foreclosure, priority collection of delinquent payments for the PACE assessment may be waived or relinquished. Unless a payoff is negotiated, the buyer will assume the obligation and will be responsible for the payments on the outstanding PACE amount.

-12-
Resident Participation
Tenant Participation Requirements

**Who:**
All HUD assisted and/or loan guaranteed project.

**What:**
HUD’s commitment to resident participation, individually and through resident organizations. They can:

- distribute leaflets in lobby and common areas, under resident’s doors posting information on bulletin boards.
- initiating contact with residents, go form door to door for surveys and distribute information
- Offer assistance for residents to participate in resident organization activities
- Convene resident organization meetings on-site without boards or management.

**Management may "not"**

- Deny accessible meeting space to residents
- When requested not to- send management representatives attends meetings anyway.
- Threatening to evict or otherwise threatening objections
- Amongst others

**Enforcement:**

- Debarment
- Suspension
- Denial of Participation
- Civil Money Penalties
MOR - Resident checklist
Resident File Review Checklist

Here's a checklist of documents that resident files should contain to show auditors that your management company is complying with HUD's rules and regulations. The checklist covers documents required at move-in; annual recertifications; interim recertifications for income, asset, and expense changes; unit transfers; gross rent changes; move-out; and other documentation such as reasonable accommodation requests. Be sure to adapt the checklist to include other documents that are part of your site's normal operating procedures. When reviewing a file, check off an item on the checklist only if the file contains the required document.

### RESIDENT FILE CHECKLIST

#### MOVE-IN

- **Rental Application.** Paperwork package completed by household when applying to live at site [HUD Handbook 4350.3, par. 4-22].
- **Social Security Number Verification** documents for every family member age 6 or older.
- **Noncitizens Rule Paperwork.** Declaration of Citizenship Form for all family members.
- **HUD Race and Ethnic Data Reporting Form,** form HUD-27061-H, for Head, Spouse, Co-Head, and recommended for all family members [HUD Handbook 4350.3, par. 4-14(A)(3)]. NOTE: When applicants do not complete the race and ethnicity form owners should place a notation in the resident file that the applicant chose not to provide the race and ethnicity certification.
- **Third-party Student Status Verification** for all adult full-time students (if applicable) [HUD Handbook 4350.3, par. 3-33].
- **Elderly Household Verification** (if applicable).
- **Third-Party Disabled Household Verification** from a doctor or other healthcare professional (if applicable).
- **Family Summary Sheet** with all family members identified correctly [HUD Handbook 4350.3, exhibit 3-4].
- **HUD Form 9887 and 9887A, Notice and Consent for the Release of Information,** signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older [HUD Handbook 4350.3, par. 3-11(A)(1)].
- **HUD Lease** signed by all adult family members.
- **Security Deposit Receipt.**
- **Lead-Based Paint Disclosure** and Documents (if applicable). Acknowledgement of receipt.
- **House Rules.** Acknowledgement of receipt.
- **Pet Rules** (if applicable). Acknowledgement of receipt.
- **Move-In Inspection** signed by the owner and Head of Household.

- **HUD Form 50059** signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older [HUD Handbook 4350.3, par. 7-17(E)].
- **Initial Notice.**
- **"How Your Rent Is Determined."** Acknowledgement of receipt.
- **Resident Rights and Responsibilities Brochure.** Acknowledgement of receipt.
- **SAVE documentation** for all non-citizen family members (if applicable) [HUD Handbook 4350.3, par. 3-12(H)].

#### SCREENING CRITERIA DOCUMENTATION

- **Criminal and sex offender background check** for all adult family members including live-in aides. NOTE: All criminal records must be destroyed once they have accomplished their intended use.
- **Prior landlord verification** (if part of the screening process outlined in the Resident Selection Plan).
- **Credit report** (if part of the screening process outlined in the Resident Selection Plan).

#### INCOME, ASSET, EXPENSE VERIFICATION

- **Disposition of Assets Certification** for all adult family members.
- **Third-party verification** of all sources of household income.
- **Third-party verifications and completed No-Income Questionnaire** for each adult family member (for households claiming no income).
- **Third-party verification** of all household assets.
- **Third-party verification of all allowable expenses.**
- **Copies of documents provided by the resident and a written explanation as to why third-party verification was not obtained** (if any required third-party verifications were not possible or delayed 14 days or more).
### ANNUAL RECERTIFICATIONS

- **Annual Unit Inspection.**
- **Recertification Notices.** Initial Notice of Recertification signed at move-in or at last recertification. Ninety-day notice, and, if necessary, 60-day notice, and 30-day notice reminding household head to report for annual recertification [HUD Handbook 4350.3, par. 7-7].
- **Recertification Interview Worksheet.**
- **HUD Form 9887 and 9887A, Notice and Consent for the Release of Information, signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older [HUD Handbook 4350.3, par. 3-11(A)(1)].**
- **HUD Form 50059 signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older [HUD Handbook 4350.3, par 7-17(E)].**
- **"How Your Rent Is Determined." Acknowledgement of receipt.**
- **Resident Rights and Responsibilities Brochure. Acknowledgement of receipt.**
- **30-Day Advance Notice of Increase in Rent [HUD Handbook 4350.3, par. 7-8].**

### INCOME, ASSET, EXPENSE VERIFICATION

- Disposition of Assets Certification for all adult family members.
- Third-party verification of all sources of household income.
- Third-party verifications and completed No-Income Questionnaire for each adult family member (for households claiming no income).
- Third-party verification of all household assets.
- Third-party verification of all allowable expenses.
- Copies of documents provided by the resident and a written explanation as to why third-party verification was not obtained (if any required third-party verifications were not possible or delayed 14 days or more).

### INTERIM RECERTIFICATIONS FOR INCOME, ASSET, EXPENSE CHANGES

- Third-Party Verification of All Sources of Household Income.
- Third-Party Verifications and Completed No-Income Questionnaire for each adult family member (for households claiming no income).
- Third-Party Verification of All Household Assets.
- Third-Party Verification of All Allowable Expenses.
- **30-day Advance Notice of Increase in Rent** (if resident complied with the interim reporting requirements).
- **HUD Form 50059 signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older [HUD Handbook 4350.3, par. 7-17(E)].**

### UNIT TRANSFERS

- **Documentation Stating the Reasons for the Unit Transfer.**
- **HUD Form 50059 signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older.**
- **Documentation that the Security Deposit was either transferred to the new unit or refunded to the resident and a new security deposit was charged for the new unit.**

### GROSS RENT CHANGES

- **HUD Form 50059 reflecting the new Contract Rent, Resident Rent, Total Resident Payment, Utility Allowance, and Assistance Payment.** The HUD Form 50059 must be signed by the Head, Spouse, and Co-Head of any age and by all adult family members age 18 or older if the Gross Rent Change changes the Resident Rent, Total Resident Payment, and/or Utility Allowance.

### MOVE-OUT

- **Move-out Notice from resident** (if resident provided notice).
- **Move-out Inspection Form signed by the resident and owner.**
- **Security Deposit Disposition Form with refund within 30 days (or sooner if required by state or local law).**
- **Copy of the Itemized List of the Damages and Charges provided to the resident (if applicable).**

### OTHER DOCUMENTATION

- Requests for Maintenance.
- Requests for Reasonable Accommodations.
- Requests for Unit Transfers.
- Resident Correspondence.
- Notice to Quit.
- Summons and Compliance Notices.
- Stipulated Judgments.
- Collection Notices.
- Other Notices to Resident.
Preservation Options for Section 236 Properties
Preservation Options for Section 236 Properties

April 2016
INTRODUCTION

Owners of Section 236 properties play a critical role in providing affordable housing for low-income families and individuals across the nation. As these mortgages mature, thousands of low-income elderly, special needs residents, and other households are at risk of losing affordable housing. The U.S. Department of Housing and Urban Development (HUD) Office of Recapitalization (Recap) is committed to working with owners to retain Section 236 units as affordable by providing incentives for their recapitalization and preservation, as well as guidance to help owners make sound decisions that benefit both owners and residents. These preservation and recapitalization options will allow owners to secure new funding for capital improvements and place their properties on solid financial footing while still serving their low-income residents. Assessing the options and taking action may seem overwhelming at first. This guide, along with other available learning tools, can help by providing a roadmap for owners in making a decision and taking action to preserve their affordable property.

There is no one-size-fits-all approach to any recapitalization effort, so the reader should consider this guide and its related set of options for preservation as a whole. A recapitalization strategy involves an overlay of interacting components, including: refinancing; possible restructuring of the Section 236 subsidy (for example, Interest Reduction Payment (IRP) decoupling); renewal of rental assistance contracts; and possible participation in the Rental Assistance Demonstration 2 (RAD 2) program and/or Low-Income Housing Tax Credit (LIHTC) program. Coordinating and considering all of the funding timelines, recapitalization requirements, and needs of the property are the key elements to success.

This guide provides information about the preservation of multifamily affordable rental properties financed with the following types of Section 236 mortgages:

- FHA-insured
- HUD-held loans
- State Housing Finance Agency (HFA)-insured

ACT NOW

Contact HUD for Help

Section 236 preservation transactions are managed in HUD’s Office of Recapitalization (Recap). Recap staff are available to help owners get started on their preservation strategies and to guide them through process. Owners may contact Recap staff at 236Preservation@hud.gov for guidance on their preservation options, to ask questions about preparing an application, and to discuss how to pay for predevelopment costs.
Organization of the Guide

A successful preservation action can be structured into a five-step approach:

**STEP 1**
Know Your Property
- Educate board and ownership
- Understand current financing
- Understand rent structure and subsidies
- Understand capital needs and adequacy of reserves

**STEP 2**
Set Your Preservation Goals
- Pay for capital improvements
- Ensure low-income residents can remain in their homes
- Provide stable project income

**STEP 3**
Choose Your Preservation Options
- Explore financing options
  - Raise Capital
  - Prepayment
  - IRP Decoupling
  - Flex Sub Loan Deferral
- Explore rental assistance options
  - Section 8
  - TPVs/EVs/PBVs
  - RAD 2

**STEP 4**
Apply for Financing & HUD Approvals
- Design improvements
- Secure contractor
- Apply for new financing and conduct due diligence
- Apply for rental assistance
- Secure HUD approvals

**STEP 5**
Secure Long-Term Stability
- Close on new financing
- Start new rental assistance
- Renovate the property
- Stabilize the property by placing it on solid financial footing

Figure 1: Five-Step Preservation Process

To learn about Step 1: Know Your Property and Step 2: Set Your Preservation Goals, readers may review the webinar and accompanying slides on How to Preserve and Recapitalize a Section 236 Property, which are posted on the Section 236 page of the HUD Exchange. This guide complements the webinar with additional detail and context. HUD has also posted a resource document called Get Started on Your Preservation Strategy, which describes the steps that an owner should take at the onset of the preservation decision-making process.

The purpose of this guide is to provide detailed guidance for Section 236 property owners on Step 3: Choose Your Preservation Options. The guide explains the requirements and processes that govern the various policies that HUD has implemented to incentivize the preservation and recapitalization of these properties. It contains guidance on the owner’s available Section 236 financing options: raising capital, Section 236 loan prepayment, IRP decoupling, and Flexible Subsidy Loan deferral. It also discusses the following rental assistance options: Section 8 contracts, Tenant Protection Vouchers, Enhanced Vouchers, Project-Based Vouchers, and RAD 2.

The guide also provides basic instructions on Step 4: Apply for HUD Approvals. It includes information about the application process for prepayment and other HUD approvals, guidance on selling a Section 236 property, and project management timing considerations. Step 5: Secure Long-Term Stability begins when the preservation preparations are completed. Owners will be able to move forward on closing on their new financing, starting any new rental assistance, and renovating their properties. This work will put their properties on solid financial footing for years to come.

Be aware that, from time to time, HUD releases new information or programmatic changes that could impact some of the approaches outlined herein. This guide is intended to be broad enough to account for small tweaks to the program, but the reader should still always check the HUD websites for any updates and the latest news. A list of relevant webpages and notices can be found in Appendix A.

Appendix B provides a checklist of documents and information that a Section 236 owner should gather in Step 1: Know Your Property. Appendix C contains a flow chart of the HUD approval process steps for a typical Section 236 preservation transaction that are referenced in Step 4: Apply for Financing and HUD Approvals. Appendix D describes considerations for selling a property because in some cases, the best preservation alternative is a sale of the property to an entity that is committed to long-term, sustainable affordability.

Additionally, the Glossary of Multifamily Housing Preservation Terms provides definitions of technical and preservation terminology.
How Does Section 236 Financing Work?

Created by Congress in 1968, HUD’s Section 236 Loan program was an effort to enlist the private market to assist with the creation of needed affordable rental housing for families and seniors. Owners could be for-profit, nonprofit, and cooperative entities.

- Market-rate loans were made by eligible lenders at the prevailing market interest rates. Loans were either HUD/Federal Housing Administration-insured or state Housing Finance Agency-financed.

- HUD provided an Interest Reduction Payment (IRP) that subsidized the borrower’s mortgage payment, making it equivalent to that of a loan with an interest rate of 1%. The IRP was fully funded to flow monthly to the mortgage lender for the entire 40-year mortgage term.

- With Lower Mortgage Payments, the owners were required to restrict occupancy to residents with incomes at or below 80% of Area Median Income (AMI).

- Consequently, HUD required reduced rents that were capped at a HUD-approved, cost-based Section 236 Basic Rent.

- Certain higher income residents may have rents capped at a higher, cost-based Section 236 Market Rent level, which reflects the full cost of the debt service without the IRP. (Section 236 Market Rent is not to be confused with actual comparable unassisted rents in the marketplace.)

- Project-based rental assistance was included for many properties in the form of a Rent Supplement (Rent Supp), Rental Assistance Payment (RAP), and/or a Section 8 Project-Based Rental Assistance (PBRA) contract.

![Figure 2: How the Section 236 Program Works](image-url)
This section describes the options and incentives that an owner will evaluate to design an effective preservation strategy, resulting in long-term affordability and stability of a Section 236 property. Choose Your Preservation Options is the third of the Five-Step Preservation Process described in the Introduction:

For the first two steps of property analysis and goal setting, guidance is provided in the resource document Get Started on Your Preservation Strategy. Also, see Appendix B for a checklist of items to gather for Section 236 properties. These documents will help the owner to:

- Understand the property’s current financing
- Understand the property’s current rent structure and subsidies
- Understand the property’s capital needs and the adequacy of its reserves to address those needs

Once an owner has a thorough understanding of the property and has set preservation goals (Steps 1 and 2), an owner is ready to evaluate options and incentives to plan the recapitalization of a Section 236 property (Step 3). Both financial and rental assistance options are available to help owners meet their goals:

- On the financing side, an owner’s options include: refinancing to raise capital, prepaying the original Section 236 loan; decoupling and continuing to use the Interest Reduction Payment (IRP) mortgage subsidy stream, and finding relief from balloon payments due on certain Flexible Subsidy (Flex Sub) Loans.
- On the rental assistance side, options include: renewal and the potential rent increase of expiring Section 8 contracts, Tenant Protection Vouchers (TPVs) that can be available as a resource, and the Rental Assistance Demonstration 2 (RAD 2) program.

**Figure 3: Preservation Options and Incentives**

**ACT NOW**

**MORTGAGE MATURING SOON?**
If the property’s mortgage is maturing in the next 12 months or has already matured, contact HUD immediately for guidance.
Typical preservation transactions require new funds to pay for large-scale capital improvements that reduce utility usage, reduce operating costs, and improve living conditions for residents. Your team's ability to successfully address these needs will rely on its ability to secure the necessary financing. Some owners may also want to recover a portion of the equity appreciation accumulated over the years, or may want to use this cash to support other affordable properties in their portfolio. Typical financing tools used in recapitalization of Section 236 projects are:

- **Hard Debt:**
  - Conventional loans
  - Federal Housing Administration-insured, Fannie Mae, Freddie Mac, or state Housing Finance Agency (HFA) loans

- **Equity:**
  - Low-Income Housing Tax Credits
  - Cash-on-cash

- **Soft Debt:**
  - HOME funds, Community Development Block Grant program funds, State housing trust funds, or National Housing Trust Funds (starting in 2016)

- Foundation and Corporate Grants

As a Section 236 owner progresses along the path of a refinancing, there are many factors to consider that are unique to Section 236 and other HUD-funded properties. Prepayment, decoupling the IRP subsidy, and Flex Sub Loan deferrals are the key options that are triggered in the recapitalization of a Section 236 property.

**RECAP TIP**

**Income Certification Requirements**

Many properties with stable occupancy also have residents paying the maximum Section 236 Market Rent. These residents do not currently have to recertify their incomes. After a refinancing and recapitalization, however, these residents may be subject to new rules related to the new financing, such as Low-Income Housing Tax Credit (LIHTC) income certification requirements. It is wise to be very aware of the various income certification requirements of the refinancing sources so that initial and ongoing compliance will not be surprising and will be less complicated.
Q: Why prepay your Section 236 loan?
A: To enable refinancing of a property
To trigger issuance of Tenant Protection Vouchers

As noted above, a refinancing indicates that an owner will be prepaying an existing loan to leverage new debt to address capital improvements. Another reason for Section 236 owners to prepay is that this may trigger the creation of Enhanced Vouchers (EVs) to protect unassisted residents from rent increases.

Owners with Rent Supplement (Rent Supp) or Rental Assistance Payment (RAP) contracts may prepay to trigger termination of these non-renewable rental subsidy contracts in order to initiate the issuance of Tenant Protection Vouchers (TPVs). This process (or the natural expiration of Rent Supp or RAP contracts) permits the owner to participate in the Rental Assistance Demonstration 2 (RAD 2) program that allows for the voucher assistance to be converted into a project-based subsidy.

Owners with Flex Sub Loans that have been deferred for the term of the loan and must be paid at maturity or prepayment may wish to prepay the Section 236 loan in order to proactively address the looming balloon note, as well as to generate EVs.

Some owners who do not need HUD permission to prepay their Section 236 loan will be prepaying without entering into a preservation transaction (see section below). This may create EVs for tenant protection and may deregulate the property, which would eliminate the property’s use restrictions.

Note that, in general, prepayment of the loan will trigger the termination of the Section 236 Regulatory Agreement. In some cases, a substitute use agreement will be required, as discussed below.

Is Prepayment Permission or Prepayment Approval Required for the Property?

Not every Section 236 loan can be prepaid “as-of-right,” permission to prepay may be required from HUD. The first consideration in determining whether HUD consent is needed for a prepayment is to examine the language of the Section 236 first mortgage note. Typically, it will state something similar to the following:

“The debt ... may not be prepaid ... prior to final maturity without the prior written approval of the Federal Housing Commissioner, except that a ... limited dividend corporation may prepay without such approval after 20 years.”

Owners of Section 236 properties that were originally developed by nonprofits may not prepay without HUD consent, and some properties with both Rent Supp contracts and Section 221(d)(3) mortgages also require HUD prepayment consent.

Limited dividend owners generally may prepay after 20 years, unless an owner has waived the prepayment right as part of a subsequent transaction, such as receipt of a Flex Sub Loan. In every case, the right to prepay must be verified by HUD’s Office of General Counsel, and the owner must follow HUD’s prepayment procedures. Therefore, the prudent course of action for owners contemplating the prepayment of a Section 236 mortgage is to engage in preliminary discussions with HUD and, in complicated cases, consult with legal counsel.

---

1 This guide uses the term “as-of-right” to refer to prepayments that are not explicitly prohibited by the terms of the note or related financing documents.
When prepayment permission is required ("Discretionary Prepayment," governed by Section 250(a) of the National Housing Act): Per Notice H 2006-11 "Prepayments Subject to Section 250(a) of the National Housing Act," HUD requires that an owner provide a 150-day advance notice to residents, to the head of the unit of local government, and to the HUD project manager/account executive. A continuing Use Agreement will remain in place through the term of the original Regulatory Agreement. HUD can also require relocation assistance, if applicable. Additionally, HUD requires the execution of a replacement Section 250(a) Use Agreement to take the place of the original Section 236 Regulatory Agreement and remain in effect through the end of the original mortgage term.

When prepayment permission is NOT required ("As-of-Right Prepayment," governed by Section 219 of the FY 1999 HUD Appropriations Act): A different tenant notice procedure is required for "as-of-right" prepayments. The prepayment notice (typically referred to as a "Wellstone Notice") must be delivered to each resident, to HUD, and to the state or local government. It must also be delivered between 150 and 270 days prior to the prepayment. Upon prepayment, the Section 236 Regulatory Agreement is dissolved. Finally, no rent increases may be implemented for 60 days after the prepayment.

Follow the Required Tenant Notice Procedures

Discretionary Prepayments: Notice H 2006-11 prescribes the tenant notice requirements for discretionary prepayments. It includes a notice template, instructions for delivering and posting the notice, a requirement for a 30-day tenant comment period, and a requirement for the owner to consider the tenant comments and to make any corresponding adjustments in the plan for the property.

As-of-Right Prepayments: Although the statute does not require a tenant comment period, it is always a useful practice to solicit such opinions. The specific delivery and posting requirements in Notice H 2006-11 provide a good guide to a best practice approach to the Wellstone Notice.

General Guidelines: When the prepayment is an essential part of a preservation transaction, it is best not only to recite the fact of the intent to prepay, but also to communicate the context and the preservation plan to residents.

HUD’s general guidelines for resident participation are found in Notice H 2014-12, “Implementation of Tenant Participation Requirements in accordance with 24 CFR Part 245.” All owners of Section 236 and other HUD-assisted properties should be familiar with these principles and requirements. This Notice states, among other things, that “Tenants also have the right to be notified of and to formulate responses to... loan prepayments,” although no specific procedures are required.

RECAP TIP

Tenant Engagement

Beyond the tenant notice requirements, it is important to engage residents early in the preservation process to seek their input regarding the needs of the community. Residents may be under the impression that affordability is terminating and may think they need to find other housing. It is especially important to communicate early and often.

Note that in some jurisdictions there may be other state or local notice laws. These are not preempted or superseded by HUD’s notice requirements and they must also be followed.

---

2 If the project matures within 150 days and prepayment permission is required, HUD can waive the 150-day requirement on a case-by-case basis. Discuss the timeline as soon as possible with HUD in these cases.

3 In certain instances where it is not practical to file a Wellstone Notice, HUD can waive this requirement but only in order to facilitate a preservation transaction and only if the owner executes a new Use Agreement.

Preservation Options for Section 236 Properties | 7
Does Prepayment Trigger Rehabilitation Requirements for the Property?

**Discretionary Prepayments:** For a discretionary prepayment that is subject to HUD approval, HUD requires in a policy clarification memo that one or more of the following rehabilitation requirements be met in order to receive prepayment permission:

- Total hard costs (rehabilitation costs) are at least $15,000 per unit.
- The rehabilitation includes the replacement or modernization of at least one major system or major building component.
- The total hard costs are greater than or equal to 25% of the Total Development Cost, which include all costs of the transaction including acquisition, rehabilitation, reserves, and fees.

In practice, HUD considers these criteria in the context of the specific preservation transaction.

**As-of-Right Prepayments:** For as-of-right prepayments, there are no rehabilitation requirements. A new funding source for the prepayment, however, may have underwriting requirements that include resolving any physical issues at the property.

---

**RECAP TIP**

**HUD Approvals**

Apply for HUD prepayment approvals at the Multifamily Preservation Resource Desk. Learn how to get started in the “Apply for Financing and HUD Approvals” section of this document.

---

**What are the Prepayment Requirements for Section 236 Properties Financed by State Housing Finance Agencies?**

While many Section 236 properties were created using HUD-insured loans via the FHA, a large number of these properties have permanent debt that was originated by state HFAs without federal mortgage insurance. Because FHA is not involved, these are sometimes referred to as non-insured, HFA-issued Section 236 loans. As with their HUD-insured counterparts, HFA Section 236 loans are assisted with IRPs and the underlying regulatory structure is identical in all material respects.

**Responsibilities:** The business terms of prepayment rights are governed by the HFA’s loan documents and by HFA policy. The HFA, as the lender, manages the Section 236 prepayment approval process, but the federal Wellstone Notice provisions still apply. Because HFA Section 236 loans are not backed by HUD, the HFA bears more risk than a HUD-insured lender. As a result, the HFA, instead of HUD, carries out most asset management responsibilities for these properties.

These responsibilities include: processing rent increases; oversight of maintenance; financial management and other regulatory compliance; and, commonly, administration of rental assistance contracts, all pursuant to HUD oversight.

**HFA Role in a Preservation Transaction:** Aside from the federally-required procedures, each HFA will manage the prepayment process according to its own business procedures. IRP decoupling, if included in the transaction, must be approved by HUD’s Office of Recapitalization (Recap). If the HFA will also be the source of new debt, it will have underwriting procedures for that process.

---

**Check in with HUD and Your HFA**

An early discussion with the HFA asset management staff and the HUD Office of Recapitalization is essential to understanding all requirements and process details.
What if the Property has an ELIHPA or LIHPRHA Use Agreement?

Some Section 236 projects have Use Agreements under the Emergency Low-Income Housing Preservation Act (ELIHPA) of 1987 or the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) of 1990. Both Acts authorized HUD to offer incentives to owners to renew the affordability of their properties and restrict as-of-right prepayments. Typical ELIHPA Use Agreements expire at the originally scheduled maturity date of the underlying mortgage loan.

Accordingly, most ELIHPA Use Agreements have already expired. LIHPRHA Use Agreements, on the other hand, remain in effect for the remaining useful life of the property. Many ELIHPA and LIHPRHA properties have very low-income non-Section 8 residents who are currently rent burdened, or who may face rent increases when ELIHPA Use Agreements expire. Prepayment of the Section 236 loan can make Enhanced Vouchers available to assist those residents and to support new financing for rehabilitation.

<table>
<thead>
<tr>
<th>REVIEW: Prepayment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prepayment when HUD Consent is Required</strong></td>
</tr>
<tr>
<td>Governed by Section 250(a) of the National Housing Act</td>
</tr>
</tbody>
</table>

**Who:**
- Nonprofits, properties with Flex Sub Loans, certain FHA loans with Rent Supp or RAP

**Tenant Notification Requirements:**
- Notify tenants, HUD, and local government at least 150 days before prepayment

**HUD Rehab Requirements:**
- Minimum rehab requirements—see policy clarification memo for prepayments subject to Section 250(a) of the National Housing Act

**Affordability Requirements:**
- Property must be maintained with equal benefits for low-income residents through the original mortgage note term
- Owner must execute a new Use Agreement (HUD Form 93142)

**Who:**
- Usually for-profit entities

**Tenant Notification Requirements:**
- Notify tenants, HUD, and state or local government 150 - 270 days before prepayment may occur

**HUD Rehab Requirements:**
- None

**No rent increases** for 60 days after prepayment

**Prepayment of State HFA Loans**
- The HFA manages the Section 236 prepayment approval process, but the federal Wellstone Notice provisions still apply
- All Section 236 preservation rules and incentives apply to these properties
- Apply for approvals through HUD as with all Section 236 projects PLUS contact the HFA about their required prepayment approvals
**Q:** Why decouple the IRP from your Section 236 loan?

**A:** Owners may "decouple" the remaining IRP subsidy at prepayment and apply it to a new loan. These funds could help leverage new debt capital.

**Understand How Decoupling Works**

The original Section 236 loans have an interest rate subsidy, called the Interest Reduction Payment, which lowers the effective loan interest rate to 1% for the borrower and is paid directly to the lender. In return for this subsidy, the owner must agree to restrict the rents and the resident incomes for the term of the mortgage. This restriction is codified through a recorded Regulatory or Use Agreement. Unless an owner could transfer or capture this IRP subsidy, it would be lost upon refinancing, reducing the incentive to refinance a Section 236 property prior to its maturity date.

To aid in preservation of these properties, Congress created direct authority for HUD to "decouple" the balance of the IRP subsidy and apply it to a new loan as part of a prepayment and refinancing transaction. Reference Notice H 2013-25, "Updated Guidelines for Continuation of Interest Reduction Payments after Refinancing: 'Decoupling,' as allowed by the National Housing Act, under Section 236(e)(2)," for the current decoupling guidance.

The decoupled IRP will flow directly to the new mortgagee until its original maturity date and at the same pay-out schedule as originally designed. Note that in some cases, upon request, the IRP may be paid over a longer period if the monthly IRP payments are reduced accordingly and the total of the revised payments is no greater than the remaining amount of IRP funds at the time of the decoupling.

**Uses of the Decoupled IRP**

The IRP stream that is decoupled from the original loan is generally used in one of two ways.²

² There is a third, little-used procedure that is authorized by Section 236(b), in which a public agency (a) purchases the original Section 236 loan from HUD and (b) issues additional debt secured by the original mortgage. The IRP continues to flow to the original note. See Notice H 2000-08 for details.

³ "Loan sizing" refers to the lender’s calculation of a borrower’s ability to repay, and in this case, the repayment is enabled by the IRP.

**New “B” Loan**

IRP subsidy is used to size² a “B” loan (secondary to the new primary “A” loan) that can be fully amortized with the balance of remaining scheduled IRP payments.

- To properly size the new B loan, the amortization schedule for the original Section 236 loan should be referenced to learn exactly how the IRP will be paid out over the remaining years. This sizing should be tied to the estimated date of the prepayment so that the most accurate amount of IRP subsidy can be used for this B loan calculation.

- Note that a lender familiar with the decoupled IRP stream will be able to size the B loan for the transaction, taking into account the fact that, for HUD-insured loans, the IRP included a small, declining mortgage insurance premium payment and is therefore not strictly level. Owners should also have a sense of the amount of the B loan, so that they can prepare their internal financial model as they consider project feasibility.

**Subsidize the New “A” Loan**

The decoupled IRP stream continues to flow to the lender to offset the new debt service payments on the new financing. In this way, it continues to subsidize the new loan.

- Since the IRP stream will not continue for the full life of the new mortgage, the lender will not consider the IRP stream in the debt service coverage calculations for sizing the new debt.

- If the decoupled IRP continues to flow to service the new first mortgage without leveraging a B loan, it will mean that the same Section 236 Basic Rent can sustain additional approved, above-the-line uses, such as programming additional cash into the Reserve for Replacements Account during that limited timeframe for smaller capital improvement projects.

- In effect, the remaining IRP subsidy can support rehabilitation work spread out over the remaining term of the original Section 236 loan. This strategy may be most useful when the remaining IRP term is too short to justify the transaction costs of a B loan.
Decoupled IRP Used to Support B Loan

An owner has a Section 236 property with a loan that matures on March 30, 2019. The owner is refinancing the property and the new loan is anticipated to close on March 30, 2015. This would result in the IRP income stream from April 1, 2015 through March 30, 2019 (48 months) being available to support a new B loan. The total IRP subsidy would be approximately $1.28 million for the four remaining years.

Using an assumed interest rate of 5.25% with a 48-month term for the B loan and the monthly equivalent of the remaining IRP balance, one can calculate a new B loan in the amount of about $1,150,000. (For simplicity, assume that the new loan does not have HUD insurance, and therefore, none of the post-decoupling IRP is needed for a mortgage insurance premium.)

This loan would be paid off in 48 months with this IRP stream. The net result to the transaction is $1,150,000 of additional proceeds for preservation activities, including capital improvements and associated soft costs.

In practice, since the IRP stream is already fully funded and is not dependent on the property’s operations, the B loan’s lender may permit a debt service coverage as low as 1.00 or 1.05.

Decoupling Requests

Apply for IRP decoupling approval at the Multifamily Preservation Resource Desk. Learn how to get started in the section “Apply for Financing and HUD Approvals” of this document.

Submitting a decoupling request as early as possible will allow HUD staff time to review and approve the transaction, and will help keep the overall recapitalization timeline on track.

Five-Year Use Agreement Extension Required in an IRP Decoupling

In return for being allowed to decouple the IRP stream, the owner must agree to a Use Agreement that extends five years past the term of the Section 236 Regulatory Agreement (or an additional five (5) years from the termination of the IRP subsidy if the remaining IRP payments are reduced and paid out over a longer term). Since the IRP stream is timed to finish at the end of the original Section 236 regulatory period, this would mean that even though the property is not receiving any additional IRP, it will still be required to comply with tenant income and rent restrictions for an additional five years beyond the original term. For those five years, the unsubsidized rents will still be set by the Section 236 rules for cost-based Basic Rent and Market Rent, including dividend restrictions. If the new debt is HUD-insured, HUD will provide oversight and enforcement of the new Use Agreement. Otherwise, a public agency must agree to provide regulatory oversight. This oversight and responsibility could be fulfilled by a public agency, such as an HFA, acting as the new permanent lender.

What are Factors to be Considered for IRP Decoupling?

Decoupling the IRP for new uses comes with many requirements, and potentially adds time and complexity to a transaction. The following are some things to consider when thinking through the possibility of decoupling.

- **Section 236 Regulatory Extension:** As noted, an additional five years of Section 236 restrictions will be added beyond the end of the IRP payments, via a Decoupling 236(e)(2) Use Agreement, including: use restrictions; income limits; continuation of the Basic Rent and Market Rent affordability limitations; and rent determination.

- **Timing and IRP Balance Available:** What is the most realistic closing date on the Section 236 loan prepayment and decoupling, and how much IRP will be remaining at that time? Generally, the per-unit dollar value of decoupling decreases as the loan maturity approaches, and the owner should carefully assess the trade off between additional debt and increased processing time and cost. Understand the IRP balance expected at closing, and consider the balance of the potential additional proceeds against the additional timeline requirements. As noted above, the remaining IRP term may influence whether or not it is used to support a B loan, but in any event, its value to the transaction can be retained.
• **Ability to Program Surplus Cash for Capital Improvements:** As detailed above, even if the IRP decoupling is not used to support a “B loan,” it could reduce net debt service until the IRP is depleted and the increased cash flow can support capital improvement projects.

• **Section 236 Budget-Based Basic Rents:** In an IRP decoupling, since the rent-setting mechanisms continue for another five years beyond the end of the IRP payments, it is important to remember how rents are calculated. The Basic Rents are allowed to cover operating costs, including the new debt service and debt service coverage, minus the IRP subsidy. HUD may waive this IRP discount used to calculate rents if necessary for financial feasibility, provided that no equity is taken out, rents are budget-based, and (if the transaction includes an ownership transfer) the sales price is not above market for the sale of comparable properties. Reference Notice H 2013-25 “Updated Guidelines for Continuation of Interest Reduction Payments after Refinancing: ‘Decoupling,’ as allowed by the National Housing Act, under Section 236(e)(2)” regarding the issues of IRP decoupling, rent setting, and change in ownership.

**RECAP TIP**

**Use of Reserve for Replacement and Residual Receipts**

In a prepayment, an IRP decoupling, and/or a refinancing scenario, the owner may be able to include the existing Replacement Reserve deposits as a source of funds. A portion of the Residual Receipts account may also be released upon HUD approval for specific property needs, following Handbook 4350.1 REV-1 (Asset Management Handbook), Chapter 25-9. However, the full Residual Receipts account will only be released to the owner at the final termination of the original Section 236 Regulatory Agreement or, if later, the expiration of any successor Use Agreement resulting from decoupling, a Section 250(a) prepayment, or any ELIHPA or LIHPRHA Use Agreement. Owners can aggregate these funds and leverage them with new capital.

**Distributions in an IRP Decoupling Transaction**

All Section 236 properties are subject to limited distributions. This remains true after a decoupling until expiration of the new decoupling use agreement. HUD permits several adjustments to the amount of the distribution, however, as follows:

- If new equity: 6% of new equity less any developer fee at the time of the transaction, including LIHTC equity, long-term deferred developer fee, and owner cash, but not grants and soft loans
- If no new equity: If there is new FHA-insured or conventional debt, or a sale from a nonprofit to a for-profit, 10% return on 10% of the new mortgage amount
- Taken only from surplus cash (not included in budget-based rent calculation)
- For HFA-issued Section 236: state or local law controls distributions

**REVIEW:**

**IRP Decoupling**

- IRP payments to a lender may be continued after a prepayment.
- Owner agrees to retain Section 236 rules for five years beyond original mortgage maturity.
- Requests are centrally processed in HUD headquarters at the Office of Recapitalization.
- Rent increases are budget-based, per Handbook 4350.1, Chapter 7.
- Permitted distributions may be increased.
4. FLEXIBLE SUBSIDY LOAN DEFERRAL

Q: Why should I defer my Flex Sub Loan?
A: You may be able to defer repayment of the loan so you do not have to make a balloon payment at prepayment, maturity, or sale.

When May the Flexible Subsidy Loan be Deferred in the Preservation Transaction?

Some Section 236 properties have Flexible Subsidy (Flex Sub) Loans, many of which were non-amortizing balloon notes that are due at maturity or prepayment of the underlying Section 236 loan. There are two categories of these loans: Capital Improvement Loan Program (CILP) loans and Operating Assistance Program (OAP) loans.

Typically, CILP Flex Sub Loans were structured to be fully amortizing loans with terms that matched the term of the Section 236 loan. Therefore the CILP Flex Sub Loans should have low outstanding balances and there should not be an unmanageable balance due at prepayment of the 236 loan. The OAP Flex Sub Loans were fully deferred loans, however, with balloon notes due at maturity or prepayment. To resolve this issue, HUD has created the ability for owners with OAP Flex Sub Loans to defer the balloon notes beyond the prepayment or maturity date, upon HUD approval.

Reference Notice H 2011-05, “Policies and Procedures for the Deferred Repayment of Operating Assistance Flexible Subsidy Loans,” to understand the deferral process and note that the request for an OAP Flex Sub Loan deferral is part of the overall Section 236 loan prepayment and, if applicable, IRP decoupling request. In general, the extended repayment term is subject to HUD underwriting regarding the need for deferral. HUD may permit an owner to defer the loan for a period not to exceed the term of any new financing or, if there is no new debt, for 20 years.

An application for a Flex Sub Loan deferral must include (among other things):

- Last three annual audits
- Cash flow projections showing repayment of the Flex Sub Loan during the prescribed period
- Written agreement to comply with program requirements

In the application for deferral the owner must evidence:

- A passing score on a Real Estate Assessment Center (REAC) physical inspection (60 or above)
- Compliance with fair housing and civil rights laws
- Satisfactory Management and Occupancy Review for the prior three years
- Compliance with audited financial statement filings for the prior three years
- Mortgage kept current over prior three years
- Compliance with excess income reporting requirements for a seven year period
- No other outstanding defaults or violations

Owners that receive a Flex Sub Loan deferral will be expected to enter into a new Extended Use Agreement that restricts the property to the same affordability requirements as were required under the original financing for the new term of the Flex Sub Loan (see above for factors determining the new Flex Sub loan term).

Deferral Requests

Apply for Flex Sub Loan deferral approval at the Multifamily Preservation Resource Desk. Learn how to get started in the section “Apply for Financing and HUD Approvals” of this document.
Flexible Subsidy Loan Deferral
Flex Sub Loans are required to be paid in full at the maturity or prepayment of the Section 236 Loan or at sale of the property.
• Capital Improvement Loans were amortized and typically have low balances.
• Operating Assistance Loans were structured as balloon payments.
The repayment requirement can cause difficulty when an owner is putting together an application to prepay and refinance a loan. As an incentive to owners to preserve the affordability of their properties, HUD allows the owner to request to defer repayment of the Flex Sub Operating Loan, which will allow it to be re-amortized for the term of the new loan.
Q: Why renew your Section 8 for 20 years?
A: Lenders and LIHTC investors expect a new 20-year contract for refinancing. It’s possible to increase rents to market level.

Many Section 236 properties have Section 8 Project-Based Rental Assistance (PBRA) in the form of Housing Assistance Payment (HAP) contracts issued by HUD that provide rental subsidy to qualified low-income residents. (Note: These HAP contracts are different from Project-Based Voucher (PBV) HAP contracts that are issued by local Public Housing Authorities (PHAs), as described in Section 6 below.) Note that after renewal, rent-setting and annual increases for PBRA units follow the rules laid out in the Section 8 Renewal Guide. It is important to understand the implications that the various preservation strategies might have on a Section 236 property’s PBRA contract. The Section 8 Renewal Guide provides the available options for renewal of the Section 8 contract, including rent setting procedures. Owners will also need to reconcile Section 8 rent underwriting requirements with the rent setting requirements of any new financing.

What Happens to my Section 8 Contract in a Section 236 Preservation Transaction?
In the case of an Interest Reduction Payment decoupling transaction for a property that has PBRA units, the existing HAP contract must be terminated and renewed for 20 years at or just before the refinancing closing. The owner must also execute a Preservation Exhibit as part of the new PBRA HAP contract that provides for automatic renewal after the 20-year term for the unused term of the contract that is being terminated and renewed. For example, if there were 3 years remaining on the existing HAP, then the property would be subject to the HAP for a total of 23 years. In addition, for certain discretionary prepayments, whether or not they decouple, the owner may be required to accept any HUD offer of a HAP renewal.

Increasing Section 8 Rents to Market
When refinancing a property, the owner may have the opportunity to request an increase in the Section 8 rents if the rents are below market.
- Many nonprofit owners have used the Mark-up-to-Budget (MU2B) process to increase the Section 8 rents when the rents are below market. As provided in the Section 8 Renewal Guide, effective November 5, 2015, this procedure is also available to certain for-profit owners without the previously-required waiver. To use the MU2B process, the budget presented to HUD must include what is called the “current” debt service amount. This has been clarified to mean the anticipated new debt service that will be the result of the refinancing. HUD allows this budget to include a line item for debt service coverage required by the new lender. In this way, a refinancing can support an increase in income to the property when the new income is used to support the new debt. See Chapter 15 of the Section 8 Renewal Guide for more details.
- The Mark-up-to-Market (MU2M) process allows some owners with certain HAP contracts to receive rent increases up to the HUD confirmed market-rate rents without the submission of a budget-based request. See Option 1 in the Section 8 Renewal Guide for more details.

Review:
SECTION 8 CONTRACTS IN A PRESERVATION TRANSACTION
- In a Section 236 refinancing, owners will want to renew their Section 8 PBRA HAP contracts for 20 years.
- Section 8 rents are set per the Section 8 Renewal Guide.
- Rent underwriting requirements for Section 8, Section 236, and funding sources such as LIHTC and FHA loans must be coordinated.

The August 2015 version noted on this web page is effective for renewal requests submitted on or after November 5, 2015.
Q: How do Tenant Protection Vouchers assist your residents?
A: TPVs provide Section 8 assistance after loss of rental assistance or a Section 236 mortgage prepayment. TPVs protect residents from being displaced due to rent increases.

**Tenant Protection Vouchers**

TPVs may be provided by HUD, subject to available appropriations, when there is a risk of involuntary resident displacement as a result of a change in a property’s subsidy status. Once issued, TPVs are subject to the normal Housing Choice Voucher (HCV) regulations and guidance (with certain exceptions for Enhanced Vouchers, as described in this section). As with all HCVs, TPVs are administered by a PHA. Rents (except for EV rents as described below) are capped at the PHA’s Payment Standard, which must normally be between 90 and 110% of the current Section 8 Fair Market Rent (FMR). As a result, owners of properties with both TPVs and HUD-issued Section 8 PBRA will have two different contract administrators: the PHA and the HUD Performance-Based Contract Administrator, respectively.

Families who are issued TPVs must qualify under new voucher occupancy standards. For example, if the family size has changed since original occupancy and no correctly-sized unit was previously available in the property, they would be considered to be over-housed or under-housed for TPV purposes. In this case the PHA would not approve their use of the TPV at the property but would approve its use for another correctly-sized unit at another property.

**Enhanced Vouchers**

Enhanced Vouchers (EVs) are a special class of TPVs, triggered in certain circumstances. EVs provide additional protections to residents, and requirements for rent setting are more flexible compared to TPVs.

**Triggering events for the issuance of EVs are:**

- **Section 236 loan is prepaid and subject to Section 219 (payment permission is as-of-right):** In an as-of-right prepayment of a Section 236 loan, the owner can request EVs for the units that are not already assisted with a Section 8 PBRA subsidy. This includes HFA-issued loans since HUD consent is not required for prepayment.

- **Flex Sub Loans:** If the property has received a Flex Sub Loan, then EVs are available when the project is preserved as affordable (as determined by HUD).

- **Section 8 PBRA:** EVs can be issued to affected residents when a Section 8 PBRA contract is not renewed at expiration.

**Unique characteristics of EVs are:**

- The contract rent may be equal to comparable market rent.

- The tenant has the right to remain in the unit (unless it is being substantially rehabilitated or converted from rental housing use).

- In the case of EVs issued as a result of prepayment (as opposed to nonrenewal of a Section 8 HAP contract), tenants with incomes up to 95% of Area Median Income (AMI) may be eligible if they are elderly, disabled, or residing in a low-vacancy area.

- In the case of prepayment-generated EVs, a floor rent equal to the rent at the time of prepayment is required, with certain exceptions for declining resident income. For all TPVs, including EVs, a tenant must requalify for the unit, as to income eligibility and the appropriateness of the unit size.
Notice H 2012-03 “Guidance on Eligibility for Tenant Protection Vouchers Following Certain Housing Conversion Actions,” summarizes the distinctions among different circumstances that trigger TPVs and EVs. The rules are complex, depending on a variety of circumstances, and the detailed guidance in this Notice should be followed.

Timing and Tenant Protection
When the Section 236 loan can be prepaid as-of-right, or when the property has received a Flex Sub Loan or is HFA-issued, don't miss the opportunity to obtain Enhanced Vouchers for eligible residents. Be sure to prepay prior to maturity, allowing enough time for required notices and to process the new vouchers.

Project-Based Vouchers
The Section 8 Project-Based Voucher (PBV) program permits a PHA to agree to link HCVs to a specific property, providing rental assistance at the project level. When TPVs are issued, they may also be converted into a PBV contract, such as through RAD 2 or the special allotments described below. This long-term PBV contract can be used to support new financing against this stable income stream.

PBV requirements are different from the Section 8 PBRA requirements in many ways. The owner contracts with the PHA rather than with HUD for PBV assistance, and the PHA manages the waiting list of tenants. After one year of living in a PBV unit, a tenant is eligible to receive a portable voucher that can be used to move to another rental unit, and the PHA fills the vacancy at the property with another HCV holder. The owner may screen voucher holders referred by the PHA. The PBV contract term may be up to 15 years, subject to appropriations, and is renewable. The rent limit is generally 110% of FMR or any excepted payment standard approved by HUD.

RECAP TIP
Benefits of Project-Basing Rental Subsidies
Properties that are preserved as affordable housing are able to lock in long-term, project-based rental subsidies that provide a stable source of rental income, which can typically produce a waiting list of potential tenants as well. Conceivably, the resulting increase in the property's income can be used to service additional debt in case the property needs to borrow money to address capital needs.

The PBV regulations at 24 CFR 983.304(c) establish contract rent setting rules that are different in a Section 236 property (including one that has decoupled the IRP), as compared to a non-Section 236 property. This table summarizes how PBV rent setting takes place in a Section 236 property.

### RENT SETTING FOR PROJECT-BASED VOUCHER CONTRACTS IN SECTION 236 PROPERTIES

<table>
<thead>
<tr>
<th>Without Decoupling the IRP</th>
<th>With Decoupling the IRP</th>
</tr>
</thead>
<tbody>
<tr>
<td>The PBV rents are set at the lesser of:</td>
<td>While Section 236 restrictions remain in place for 5 additional years, the PBV rents are capped by the Section 236 Basic Rent.</td>
</tr>
<tr>
<td>• The public housing authority's (PHA) payment standard (not to exceed 110% of Section 8 Fair Market Rent (FMR) or the HUD-approved exception payment standard, if higher)</td>
<td>• If the Section 236 Basic Rents are much lower than the other three potential PBV rent caps without decoupling, compare the benefit of using the decoupled IRP to that of a potentially higher PBV rent when the IRP is not decoupled.</td>
</tr>
<tr>
<td>• The reasonable (i.e., market-comparable) rent</td>
<td>• However, note that, in a preservation transaction involving decoupling, the new Basic Rent will factor in the new debt service, so this limitation may not have a practical effect.</td>
</tr>
<tr>
<td>• The owner’s request</td>
<td></td>
</tr>
</tbody>
</table>
Special Allotments for Projects That Do Not Normally Qualify for Tenant Protection Vouchers

Notice HUD 2015-07 "Funding Availability for Tenant-Protection Vouchers for Certain At-Risk Households in Low-Vacancy Areas – Fiscal Year 2015" implemented a $5 million allotment of EVs or PBVs permitted by Congress for, among others, certain Section 236 properties in low-vacancy areas where residents are at risk of displacement due to mortgage maturity or expiration of related HUD use restrictions. This includes both properties that require HUD permission to prepay and other properties with mortgages that have already matured. Congress has provided a series of annual special set-asides of TPVs, and owners should look out for new special allotments that may benefit their unassisted residents. These allotments will typically be announced on the HUD Housing Notices page on HUDCLIPS.

**Vouchers**

**Tenant Protection Vouchers (TPVs)**
- TPVs are issued through the local Public Housing Authority (PHA).
- TPVs may be Enhanced Vouchers (EV) or regular Housing Choice Vouchers (HCV).
- TPVs can be triggered by Section 236 mortgage prepayment, creating a resource to benefit residents and the property.
- Availability is subject to annual appropriations.
- Residents and units must be qualified.
- Vouchers are portable; they follow the resident and are not attached to the property.

**How are EVs different than TPVs?**
- EVs are a category of TPVs.
- EVs are triggered in certain circumstances.
- EVs provide additional protections to residents compared to TPVs.
- EV requirements for rent setting are more flexible than TPVs.

**Project-Based Vouchers**
- TPVs may be converted to Project-Based Vouchers in certain circumstances (for example, RAD 2).
- Special PBV contract rent setting requirements apply in a preservation transaction that includes IRP decoupling.
FAQs on new Utility Allowance
Implementation Period

1. **Question:** What is the effective date of this notice?

   **Answer:** The implementation schedule is based on the contract anniversary date. If that date falls within the first 180 days after the publication of the notice (6/22/15), then the owner has a choice—s/he can choose to follow the new methodology, or follow the existing methodology. If the contract anniversary date is more than 180 days after the publication of the notice, s/he must follow the methodology in the notice.

Baseline Analysis

2. **Question:** What documentation will an O/A be required to submit with a utility analysis and request for approval of a U/A?

   **Answer:** The O/A shall submit backup information that demonstrates how s/he calculated the new utility allowance(s). HUD/CA has discretion to determine the documentation needed to support the utility allowances.

   Some examples of backup information include:
   1. Copies of the tenant data received from utility providers, this is typically in summary format; or
   2. Copies of the printouts indicating a summary of monthly data if the tenant was able to obtain data online from their utility provider for the previous 12 months, or 10 months if the case may be; or
   3. If the O/A obtained actual monthly utility bills from a tenant, the O/A may submit a spreadsheet summarizing the average of the monthly bills. Actual utility bills may be requested at the discretion of HUD/CA. These bills, regardless of whether they are provided to HUD/CA, must be retained by the owner for three years;
   4. At the discretion of HUD/CA, there may be cases where a combination of the above will need to be performed.

3. **Question:** When completing a baseline analysis, is there a limit to the age of data used to make the analysis?

   **Answer:** A utility analysis should be prepared four to six months prior to the anniversary date of the contracts, with submitted data covering the prior 12-month period. Thus, at the time of contract renewal, the data used in the utility analysis to support the utility allowance would generally be no more than 18 months old.
4. **Question:** We have some residents whose utility accounts are in a relative’s name and the utility company will not provide the information based on the resident’s signature. What do we do then?

   **Answer:** Have the relative obtain the info, or if possible, use other units for your sample.

5. **Question:** If an apartment is only occupied by a resident for 10 months, how do we handle the other 2 months and any partial months?

   **Answer:** Get an average for the unit for the 10 months; do not use the partial months.

6. **Question:** When a resident vacates an apartment and another resident moves in, the utility company will only release the information for the current resident. Even if the apartment was vacant for only a few days, we may not have 10 months of usage for the new resident. How do we handle that?

   **Answer:** In years when UA baseline calculations are anticipated, make every effort to collect information for the vacating resident prior to their departure. While you need 10 months of utility data for the same unit, the resident can change. In other words, you could have 5 months for one resident and 5 months for another resident. If you cannot obtain the information for at least 10 months, you should not use the unit in the sample.

7. **Question:** Can an O/A combine methods of data collection (some bills from residents, some information from the utility provider)?

   **Answer:** You can use either method, or both. There may be cases in which the O/A has no choice but to combine methods.

8. **Question:** Some CAs/HUD offices require that estimated amounts for certain appliance usage be removed from the total utility bill. For example, owner/agents may be required to remove costs to run AC or to use washer/dryers installed in the units. Is this a HUD requirement or are individual agencies allowed to implement such requirements?

   **Answer:** This is not a HUD requirement nor should any agency or HUD office impose such a requirement.

9. **Question:** Please clarify the rounding to the nearest whole dollar – in some cases there have been differences due to rounding.

   **Answer:** Collect the data and calculate the average in dollars and cents, and then round the resulting U/A to the nearest dollar (>= .50 round up, <= .49 round down)
Sample Size

10. **Question:** If the owner is unable to obtain the minimal sample size despite best efforts, will the analysis be accepted based on available data?

   **Answer:** The owner must demonstrate that every effort has been made to obtain the required sample and to otherwise meet the requirements of the analysis. It is an owner’s responsibility to provide an analysis that follows the protocol outlined in the notice as closely as possible, recognizing that the “perfect” sample may not always be available. It will be HUD’s or the CA’s responsibility, as appropriate, to make sure that the analysis justifies the resulting U/As, with whatever compromises in the sampling were necessary to achieve that analysis. The CA, in consultation with HUD, may require the owner to complete another baseline the following year.

11. **Question:** For smaller properties, especially senior properties, that may have to use 100% sampling, certain circumstances will skew the resulting U/A up or down, e.g. residents spending weeks or months in a hospital, residents spending (colder) months with relatives, residents with medical conditions who need their apartments to be exceptionally warm, cold, or where they use medical equipment that uses a lot of energy. In most cases, the resident has not requested a reasonable accommodation to increase the U/A.

   **Answer:** Smaller properties will necessarily require a proportionately larger sample size (including 100% sampling) in order to ensure statistically valid results. Management should encourage residents with medical equipment who have extraordinary utility bills to seek a reasonable accommodation for a higher utility allowance.

12. **Question:** If the property has 20 or fewer apartments and information is not available for at least 10 months in any number of units, does the sample size get reduced? For example: Property has 15 units so all the units must be included in the sample. However, 2 units are vacant and 2 units have only been occupied by the current resident for 5 or 6 months.

   **Answer:** Even if 100% sampling is required, owners must exclude units that have not been occupied for at least 10 months. (see also question 9).

13. **Question:** Can you clarify the instruction on excluding units with less than 12 months of occupancy? The instructions indicate that a unit must be excluded if it has been vacant for 2 or more months, but then indicate that a unit with only 10 months of occupancy may be included.

   **Answer:** The notice should have said to exclude units that have been vacant more than 2 months; units with only 10 months of occupancy may be included.

14. **Question:** Can you elaborate on sample sizes when the property has multiple floor plans for same bedroom size?

   **Answer:** You would treat them as two different unit sizes if they appear on your rent
schedule that way and sample for both sizes. For example, your rent schedule may indicate both a One Bedroom Unit and then a One Bedroom Unit (Large). This indicates that the unit size is different but the number of bedrooms is the same. It is likely that the U/A is different as well. If this is the case, these unit types should be considered individually. (If you are using the HUD worksheet attachment to the notice, you would amend it to include this additional unit type.)

15. **Question:** Can you use the usage amount for residents paying a flat rate, especially if most residents are paying a flat rate?

**Answer:** Generally, you would exclude the units of residents paying a flat rate, but this rule assumes that those units are the minority of units. If most residents pay a flat rate, including them in the sampling will give you a sample more representative of the whole. If you do so, document your reasons for doing so to help the CA/HUD determine if your approach was reasonable. And if you include these units, calculate the average based on the flat rate, not on the usage.

16. **Question:** Is the UA Analysis for all units at the property or just Section 8 units?

**Answer:** The U/A analysis covers only those units that receive a U/A; only HUD-assisted units will be included in the analysis.

17. **Question:** Is the flat utility rate exclusion meant to apply to any unit receiving any kind of subsidy or just units that receive a flat utility rate? We have a variety of low income assistance programs that are not rate-based but result in lower utility bill amounts and would skew the average.

**Answer:** For now, the exclusion applies only to units with flat utility rates. We will review this policy and determine the best treatment of units receiving varying forms of subsidies. We welcome your feedback on this issue.

**HUD’s Utility Analysis Excel Worksheet**

18. **Question:** Must an owner use the HUD-provided worksheet that was attached to the notice?

**Answer:** No, owners may develop their own worksheets to suit their needs, as long as they provide HUD/CA with adequate documentation.

19. **Question:** With the worksheet protected - how can we change to accommodate the same unit type i.e. 3 BR & 3 BR TH?

**Answer:** An unprotected version has been posted to HUDCLIPS. (Password is Sharkey)

20. **Question:** The HUD worksheet calculates averages based on the values entered. If you only have 10 months of data and enter 0 in the other two months, the average will calculate on all months that have data. Is this correct?
Answer: No, you should not enter any value for the months that are vacant (do not enter $0). Or, using the unprotected version of the worksheet that is now available, change the formula so that the average is calculated on only non-zero months. If you have only 10 months of data, the average must be calculated on only those 10 months.

**Release Forms**

21. **Question:** The utility company requests we use their form for the release of information; is this okay?

   **Answer:** The release form included with the notice is a sample. Owner/agents may use their own release form or a release form provided by the utility provider.

22. **Question:** Can refusal to sign a tenant release form be considered a lease violation?

   **Answer:** Yes. Tenants refusing to sign a release form constitutes material noncompliance with the lease agreement, as defined in the lease agreement, and repeated violations can result in termination of tenancy. Further, for properties other than 236 and 221(d)(3), not signing the release form is a violation of the regulatory obligations of the family found at 24 CFR 5.659(b)(1).

   To add clarity to the requirement, owners are encouraged to include language in their House Rules advising tenants of their obligation to sign release forms and to provide any information deemed necessary in administration of the program, or face possible termination. Any changes to a property’s House Rules must be done according to the procedures outlined in HUD Handbook 4350.3, REV-1 paragraph 6-9.

**Mid-year U/A adjustments**

23. **Question:** When a change in utility rates results in a 10% or more increase in the U/A, how do you compute the new allowance? Do you simply apply the % increase to the existing U/A?

   **Answer:** Yes, you would apply the utility rate increase to that component of the U/A allowance, e.g. electric rates go up 15% so if the U/A for the property comprises both electricity costs and gas costs, you would apply the 15% to the electricity component of the U/A.

24. **Question:** What would be the historical time period to use for the new analysis?

   **Answer:** The notice indicates that when rate increases cause U/As to increase 10% or more, an owner can submit the following evidence of the change: (1) utility bills from the month prior to the rate change and the first month after, or (2) other verification of the increase from the utility provider. So in that case, the owner isn’t looking at historical data, but actually justifying the rate increase with the most current data.
Utility Assistance As Income

25. **Question:** Some tenants receive assistance under the Department of Health and Human Services Low-Income Home Energy Assistance Program (LIHEAP). According to Handbook 4350.3 Exhibit 5-1 Income Inclusions and Exclusions, this form of assistance is listed under Income Exclusions (e). The notice states that tenants must report this type of assistance as income and that it must be counted as income. Is it included or excluded?

**Answer:** Although the notice indicates that this type of assistance must be reported as income, assistance under this specific program is excluded from income. Please see the May 20, 2014 Federal Register for the current list of federally mandated exclusions from income, here: [http://www.gpo.gov/fdsys/pkg/FR-2014-05-20/pdf/2014-11688.pdf](http://www.gpo.gov/fdsys/pkg/FR-2014-05-20/pdf/2014-11688.pdf)

26. **Question:** For properties in California, should the Climate Credit shown on some utility bills be included in the Utility Allowance calculation?

**Answer:** No. The California Climate Credit should not be used by owners in calculating utility allowances and should be removed from the cost totals. This is because, while the California climate credit is delivered to California residents through their utility bills, the California Public Utilities Commission (CPUC) has held that the climate credits “should not be considered a reduction in the individual customer’s electricity bill.” Instead of being used to offset utility allowances, California climate credits should be considered “income” for the purposes of recertification. This guidance applies only to the California Climate Credit. Questions about other similar benefits should be submitted to HUD for individual review.

The Factor-Based Utility Allowance Analysis

27. **Question:** Can you provide the link to the website referenced in the Notice regarding the factor-based increases and the UAF?

**Answer:** [http://www.huduser.org/portal/datasets/muaf.html](http://www.huduser.org/portal/datasets/muaf.html)

28. **Question:** What is the timing of the issuance of the Utility Allowance Factor (UAF)?

**Answer:** The UAF is a component of the OCAF and so will typically be published yearly when the OCAF is published.

29. **Question:** When will the UAF be effective?

**Answer:** Going forward, Utility Allowance Factors will be effective on the same date as the OCAF, which is typically February 11 of each year. Factors for 2017 will be released at the same time as the FY 2017 OCAF.

30. **Question:** In the years in which you perform a factor-based analysis, do you take the previous utility allowance before rounding or after rounding and then apply the factor.
Answer: You apply the factor to the previous approved utility allowance, which was the utility allowance after rounding. For example, if the previous year's baseline analysis yielded an average 2-bedroom utility allowance of $38.49 and the approved utility allowance was thus $38 (after rounding), then in second year, the factor would be applied to $38.

31. Question: For the two years after a baseline utility analysis is completed, the Utility Allowance Factor (UAF) can be used. According to the Notice, the O/A “should compare the adjusted utility analysis to their paid utilities over the previous twelve months. If the results indicate a “significant disparity” between the two, the OA should complete a baseline analysis.” Please clarify what constitutes a “significant disparity,” and whether the paid utilities analysis documentation needs to be provided to the CA/HUD in order to use the UAF. Please also clarify the “paid utilities” – does this represent the common area utilities paid by the property?

Answer: A new baseline analysis is not mandated. We do want owners to look closely at the results of a factor-based analysis, and expect that they will make an appropriate decision about further analysis if those results appear very different from what their own paid utilities suggest (i.e., their common area utilities). This analysis does not need to be provided to the CA/HUD. The comparison is intended to have owners take a “second look” at the factor-based results. If it is suspected that special circumstances cause year-to-year fluctuations that materially differ than the utility adjustment factor, owners and CAs may consider completion of a new baseline.

32. Question: Does the U/A have to be changed for all baseline transactions, even one dollar?

Answer: Yes, factor-based as well, whether it is an increase or a decrease.

33. Question: Will the UAF be applied automatically to the previous year’s utility allowance?

Answer: No, HUD systems will not automatically apply the UAF to the previous year’s utility allowance, nor is it the PBCA’s responsibility. Utility allowance regulations require an owner to “submit an analysis of the project’s utility allowances” for review and approval each year. This requirement extends to the factor-based years in which an owner will show how the factor was applied and identify the resulting utility allowance recommendation.

Utility Allowance Decreases – Phase In

34. Question: Are O/As required to phase-in a UA decrease?

Answer: Yes, but only in the initial implementation of the new methodology, and only if the decrease exceeds 15% AND is equal to or greater than $10.
35. **Question:** When is eligibility for a utility allowance phase-in determined?

**Answer:** Utility allowance phase-in eligibility is determined at the time of the first baseline analysis after implementation of Housing Notice 2015-04 only. At this time, the total decrease should be examined to determine if the decrease is more than 15% or $10 from the last utility allowance provided.

36. **Question:** Please provide an example of how phase-in of a very large utility allowance decrease would be implemented over three years.

**Answer:** Here is an example of this type of phase-in.

**Year One**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Utility Allowance</td>
<td>$90</td>
</tr>
<tr>
<td>Decrease in First Year</td>
<td>40%</td>
</tr>
<tr>
<td>New Calculated Utility Allowance</td>
<td>$54</td>
</tr>
<tr>
<td>Year 1 Utility Allowance*</td>
<td>$77*</td>
</tr>
</tbody>
</table>

* With a phase-in cap of 15% each year, the new capped utility allowance is $77 ($90 - 15%). This is the utility allowance that gets implemented in Year 1.

**Year Two**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Second Year UAF</td>
<td>+ 2%</td>
</tr>
<tr>
<td>New Actual Utility Allowance</td>
<td>$55 ($54 + 2%)</td>
</tr>
<tr>
<td>Tenant’s Second Year Capped Utility Allowance*</td>
<td>$65* ($77 - 15%)</td>
</tr>
</tbody>
</table>

* The utility allowance that gets implemented in Year 2 is $65 even though the calculated utility allowance is $55.

**Year Three**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third Year UAF</td>
<td>+ 2%</td>
</tr>
<tr>
<td>New Actual Utility Allowance</td>
<td>$56 ($55 + 2%)</td>
</tr>
<tr>
<td>Tenant’s Third Year Utility Allowance*</td>
<td>$56*</td>
</tr>
</tbody>
</table>

* Implement the actual calculated utility allowance as it is less than 15% lower than the previous year’s utility allowance.

In this example, the phase-in occurs over two years of the cycle (baseline year, plus first factor-adjusted year). In each of the factor adjusted years, the factor is applied to the previous year’s calculated utility allowance, i.e. what the utility allowance would have
been if there were not a cap put on it because of the requirement to phase it in. After that, there is a new baseline and phase-in requirements no longer apply.

Any year there is a decrease in the utility allowance, tenant notification must be provided.

**Miscellaneous**

37. **Question:** Does the data used in the analysis for each unit have to be from the same time period for each unit?

   **Answer:** Yes, to the greatest extent possible.

38. **Question:** I have 3 contracts on one property - is analysis by contract or property?

   **Answer:** By property (keeping in mind that if the property consists of multiple buildings, the buildings must be substantially similar in order for you to sample by unit size property wide).

39. **Question:** I completed a utility analysis for a 2015 contract renewal that was due prior to June 22, 2015. If this baseline analysis complied with the requirements described in the Notice, do I have to complete a new baseline for 2016?

   **Answer:** Yes, your next utility analysis must be a baseline in accordance with the requirements of the notice.

40. **Question:** May an owner offer residents monthly incentives to provide copies of their utility bills every month? For example, $1.00 or $2.00 per month per resident as “Additional Costs to Rent” in the budget.

   **Answer:** Owners may offer incentives but they may not pay for them out of project funds nor include them as an expense in the budget.

41. **Question:** Which utility allowance calculators are HFA approved?

   **Answer:** The notice intentionally does not identify pre-approved tools as the field is changing regularly. This is the pertinent language in the notice:

   "The energy consumption model must, at a minimum, take into account specific factors including, but not limited to, unit size, building orientation, design and materials, mechanical systems, appliances, and characteristics of the building location. Second, the utility estimates must be calculated by either (1) a properly licensed engineer or (2) a qualified professional approved by HUD."

   One example, however, is the CUAC tool, which is available for use in California, from the website of the Tax Credit Allocation committee. For the specific question re: HFAs, owners would need to talk with an HFA directly.
42. **Question:** A Section 811 PRA property with a RAC that specifies use of the HUD Multifamily Housing policy for developing utility allowances will use the methodology outlined in the Notice. Do Section 811 PRA owners have to separate the PRA units from the project-based units or can all units be included in one analysis?

**Answer:** Section 811 PRA properties must complete an analysis which separates the PRA units from the project-based units.
HUD Notice on Tenant Participation
NOTICE H 2016-05

Issued: March 31, 2016
Expires: This notice remains in effect until amended, superseded, or rescinded.

Cross References: HUD Handbook 4381.5 REV-2 The Management Agent Handbook

Subject: Revision of Tenant Participation Requirements in accordance with 24 CFR Part 245

A. Purpose

This notice restates requirements issued through Notice H 2014-12 and revises penalties for non-compliance. Specifically, the revisions expand the property types that may be assessed civil money penalties to additionally include non-insured projects that have a project-based Section 8 contract that has been renewed under the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA). In addition, the notice expands discussion of accessible meeting space and clarifies the role of HUD-initiated conciliation in resolving tenant complaints. All other sections of Notice H 2014-12 are incorporated herein with minor or no revisions.

The Department of Housing and Urban Development’s regulations governing tenant participation in multifamily housing projects are found at 24 CFR Part 245 Subpart B. These regulations reflect the Department’s commitment to tenant participation, individually and through legitimate tenant organizations as defined in 24 CFR 245.110. The Department believes that tenant participation is an important element to maintaining sustainable projects and communities. This Notice addresses available sanctions and the use of civil money penalties as tools to enforce the Department’s commitment to tenant participation.

B. Applicability

Except as otherwise expressly limited in this section, this part applies in its entirety to a mortgagor or owner of any multifamily housing project that meets any of the following:

1. For a project that is subject to a HUD insured or Secretary-held mortgage under the National Housing Act. The project has a mortgage that:

   a. has received final endorsement on behalf of the Secretary and is insured or held by the Secretary under Title II of the National Housing Act; and

   b. is assisted under:

i. Section 236 of the National Housing Act (12 U.S.C. 1715z-1);

ii. The Section 221(d)(3)/(d)(5) Below Market Interest Rate (BMIR) Program 12 U.S.C. 1715(d)(3)/(d)(5);

iii. The Rent Supplement Program (12 U.S.C. 1701s); or

iv. The Section 8 Loan Management Set-Aside Program (LMSA) following conversion to such assistance from the Rent Supplement Program assistance.

2. Formerly HUD-owned project. The project, before being acquired by the Secretary was assisted under:

   a. Section 236 of the National Housing Act (12 U.S.C. 1715z-1);
   
   b. The Section 221(d)(3)/(d)(5) BMIR Program (U.S.C. 1715(d)(3)/(d)(5));
   
   c. The Rent Supplement Program (12 U.S.C. 1701s); or
   
   d. The Section 8 LMSA Program following conversion to such assistance from assistance under the Rent Supplement Program, and
   
   e. Was sold by the Secretary subject to a mortgage insured or held by the Secretary and includes an agreement to maintain the low- and moderate-income character of the project.

3. State or local housing finance agency projects. The project receives assistance under Section 236 of the National Housing Act (12 U.S.C. 1715z-1) or the Rent Supplement Program (12 U.S.C. 1701s) administered through a state or local housing finance agency, but does not have a mortgage insured under the National Housing Act or held by the Secretary.

4. The project receives project-based assistance under Section 8 of the United States Housing Act of 1937 (this regulation does not cover tenant participation in Public Housing Authority(s) (PHAs) that administer such project-based assistance).

5. The project receives enhanced vouchers under the Low-Income Housing Preservation and Resident Homeownership Act of 1990, the provisions of the Emergency Low-Income Housing Preservation Act of 1987, or the Multifamily Assisted Housing Reform and Affordability Act of 1997, as amended.

6. The project receives assistance under the Section 202 Direct Loan program or the Section 202 Supportive Housing for the Elderly Program.

7. The project receives assistance under the Section 811 Supportive Housing for Persons with Disabilities Program.
8. Cooperative mortgagors are not subject to the provisions of 24 CFR 245
Part B

C. Rights of Tenants and Tenant Organizations

1. Rights of tenants to organize

a. 24 CFR 245.100 provides tenants of a covered multifamily housing project the right to establish and operate a tenant organization for the purpose of addressing issues related to their living environment as well as activities related to housing and community development. A tenant organization is considered legitimate if it has been established by the tenants of a multifamily housing project covered under Section 245.10 for the purpose described above, and meets regularly, operates democratically, is representative of all residents in the development, and is completely independent of owners, management, and their representatives. The definition of legitimate tenant organization includes “organizing committees” newly formed by residents, and does not require specific structures, written by-laws, elections, or resident petitions.

b. A link to this Notice will connect the reader to a brochure entitled “Resident Rights & Responsibilities” which addresses tenant rights to organize. Owners and/or management agents are required to provide the head of household with a copy of this brochure at move-in and annually at recertification (Ref: HUD Handbook 4350.3 REV-I: Occupancy Requirements of Subsidized Multifamily Housing Programs, Chapter 6-27, Paragraph B.1.i.). This brochure is provided in accessible formats, as necessary, to ensure effective communication with persons with disabilities and those who are limited English proficient.

2. Protected activities

a. 24 CFR 245.115 identifies activities that owners and management agents must allow tenants and tenant organizers to conduct related to establishment or operation of a tenant organization. These activities include:

   i. distributing leaflets in lobby and common areas, under tenants' doors, posting information on bulletin boards,

   ii. initiating contact with tenants, conducting door-to-door surveys to ascertain interest in establishing a tenant organization, and to offer information about the tenant organization,

   iii. offering assistance for tenants to participate in tenant organization activities, and

   iv. convening tenant organization meetings on-site in a manner that is fully independent of management representatives. In order to preserve the independence of tenant organizations, management representatives may not attend such meetings unless invited by the tenant organization.

---

b. Tenants also have the right to be notified of and to formulate responses to

i. owners' requests for budget-based rent adjustments,

ii. partial payment of claims,

iii. conversion from project paid utilities to tenant-paid utilities,

iv. a reduction in tenant utility allowances,

v. converting units to non-residential use, cooperative housing, or condominiums,

vi. major capital additions, and

vii. loan prepayments.

3. Meeting space

a. Owners and management agents of covered projects must reasonably make available the use of any community room or other available space appropriate for meetings when requested by tenants or the tenant organization for activities related to the operation or establishment of the tenant organization, or to address issues related to their living environment collectively. Owners must give priority to meeting spaces that provide physical access for individuals with disabilities in accordance with the regulations implementing Section 504 of the Rehabilitation Act of 1973 (Section 504) and Titles II and III of the Americans with Disabilities Act of 1990 (ADA), as applicable. All programs or activities must be held in accessible locations unless the owner can demonstrate that doing so would result in a fundamental alteration of the program or an undue financial and administrative burden. The owner must take any action that would not result in such an alteration or such burden but would ensure that individuals with disabilities receive the benefits and services of the program or activity. Individuals with disabilities must receive services in the most integrated setting appropriate to their needs. In addition, if owners and management agents of covered projects organize or facilitate such meetings, then the owners and management agents of covered projects must take appropriate steps to ensure effective communication with individuals with disabilities through the provision of appropriate auxiliary aids and services as applicable and required by Section 504 and/or the ADA. Similarly, owners and management agents of covered projects must make reasonable accommodations for individuals with disabilities.

b. An owner may charge a reasonable fee, approved by HUD and received into the project's account, as may normally be imposed for use of such facilities in accordance with procedures prescribed by HUD. An owner may elect to waive this fee and is not required to charge a HUD-approved fee. An owner does not need HUD approval to waive this fee.
c. The process of obtaining HUD approval for a fee will proceed according to the following:

i. Owner/management agents will submit a request, with supporting documentation (such as rates for similar areas of space from similar projects in near proximity), to charge a tenant organization/committee a reasonable fee for using community space or facilities.

ii. Hub/PC staff will approve the fee, if reasonable, as evidenced by supporting documentation.

iii. If such charges are recurring, owner/management agents are not required to request HUD approval for each charge.

iv. Any HUD-approved fee must be documented in the monthly accounting reports and/or Annual Financial Statements (AFS), depending on the frequency of the charge.

4. Tenant Organizers

a. 24 CFR 245.125 defines a “tenant organizer” as a tenant or non-tenant who assists other tenants in establishing and operating a tenant organization, and who is not an employee or representative of current or prospective owners, managers, or their agents, owners and management agents must allow tenant organizers to assist tenants in establishing and operating tenant organizations.

b. A non-tenant, “tenant organizer” must be accompanied by a tenant while on the property of the multifamily housing project only in cases where the project has a consistently enforced, written policy against canvassing. Where there is such a non-canvassing policy, non-tenant organizers must be afforded the same rights and privileges as other uninvited outside parties. Where there is no such policy against canvassing, the project shall be treated as if it has a policy favoring canvassing.

D. Impediments to residents or resident associations attempting to exercise their rights

1. HUD Handbook 4381.5 (REV-2), The Management Agent Handbook, Chapter 4 “Working with Residents” Section 4.8d identifies specific actions by owners and management agents that constitute impediments to residents or resident associations attempting to exercise their rights. These include:

a. Unreasonable denial of accessible meeting space to residents;

b. Repeatedly sending management representatives to resident meetings when residents have requested management not to attend;

c. Evicting, threatening to evict, withholding entitlements, or otherwise penalizing residents for organizing or asserting their rights;
d. Attempting to form a competing resident organization under the control of the management company or the owner; and

e. Running for office or otherwise serving as a member of the resident organization.

**E. Enforcement options**

1. Owners, management agents, principals, or affiliates of projects with an insured and assisted mortgage described in 24 CFR Section 245.10(a)(1) who violate any provision of 24 CFR Part 245, Subpart B, may be liable for one or more of the following sanctions:

   a. Debarment – an exclusion of an individual, organization and its affiliates from conducting business with any Federal Agency government-wide. Debarment is the most serious compliance sanction and is typically imposed for a three-year period. See Title 2 CFR Part 2424.

   b. Suspension – a temporary action with the same effect as debarment. See 2 CFR Parts 180 and 2424.

   c. Limited Denial of Participation (LDP) – an action that excludes a party from further participation in a certain HUD program area. The scope of the LDP may also be limited to a certain geographic area, and generally expires in one year. See 2 CFR Part 2424.

   d. Civil Money Penalties – fines which may be imposed on owners, principals of owners, and management agents who knowingly and materially fail to comply with any provision of 24 CFR Part 245, Subpart B, and, therefore, fail to provide management for the project acceptable to the Secretary, or fail to administer the subsidy contract in accordance with HUD regulations and requirements. By adjustment under the Federal Civil Penalties Inflation Adjustment Act of 1990, the maximum civil money penalty for each offense is currently $42,500, but the actual amount of the penalty is determined by applying the factors listed in 24 CFR Section 30.80. These include, among other things, the gravity of the offense, the owner's history of prior offenses, injury to the public resulting from the violations, the owner's culpability for the violations, and the owner's ability to pay the penalty. As these will vary from case to case, there is no schedule of Civil Money Penalty amounts. The actual amount sought in any particular case depends on the Departmental Enforcement Center's (DEC) analysis of the factors as they apply to each case.

2. Owners, management agents, principals, affiliates of projects assisted under provisions described in 24 CFR Section 245.10(a)(2)-(7) who violate any provision of 24 CFR Part 245, Subpart B, may be liable for one or more of the above sanctions except for civil money penalties.

However, civil money penalties, as described in Section E.1.d of this Notice, may be imposed in relation to non-insured properties that have a project-based Section 8 contract that has been renewed under MAHRA.
F. Enforcement Process

1. A tenant or tenant organization may file a written complaint with the local HUD office, with copies to the owner/management agent, alleging a consistent pattern of violations of HUD program requirements. A tenant or tenant organization may file a written complaint citing a single violation describing conditions that cause serious injury to tenants or the public.

   a. The written complaint must include factual evidence presented in support of the complaint. Evidence supporting the complaint may be:

      i. signed statements from tenants who have observed violations of 24 CFR 245 Subpart B or other program obligations,

      ii. documents from owners expressing opposition to tenant organizing activities,

      iii. documents denying the use of facilities for purposes of organizing an association or holding meetings, and

      iv. any other form of documentation may be considered when providing evidence supporting the complaint.

   b. The Regional or Satellite Office Director must attempt to bring the parties together to endeavor to achieve conciliation with respect to every tenant complaint. If both parties agree to participate in a conciliation process and are able to reach an agreement that would correct the alleged violations, they will execute a conciliation agreement outlining the terms for such correction. The Regional or Satellite Office Director will approve and sign the agreement but only if it thoroughly ensures that the conditions or circumstances underlying the tenant complaints have been addressed. If either party breaches the agreement, the Regional or Satellite Office Director can reopen the case and pursue enforcement action.

   c. The choice to participate in conciliation is voluntary on the part of both parties. If either party refuses to participate in conciliation, or if the conciliation effort does not result in a mutually acceptable agreement, the Regional or Satellite Office Director will conduct a thorough investigation into the alleged violations. If, upon completion of the investigation, he or she finds no reasonable cause to believe that a violation has occurred, the Regional or Satellite Office Director will issue a determination of "no reasonable cause" and close the case. Notification of the determination must be provided to the complainant, owner, and management agent.

   d. If, after conducting a thorough investigation, the Regional or Satellite Office Director determines that the owner has committed one or more violations of the requirements contained in 24 C.F.R. Part 245, the Regional or Satellite Office Director will provide written notice of the violations to the owner. The notice will describe the violations and direct the owner to correct them within 30 days. If the applicable regulatory agreement and/or HAP contract requires the owner to
provide management for the project that is acceptable to HUD, the Regional or Satellite Office Director’s notice will further inform the owner that its violations of 24 C.F.R part 245 constitute unacceptable management and, therefore, are also violations of the regulatory agreement and/or the HAP contract.

e. If the owner fails to respond, or the response does not satisfactorily address the violations alleged in the Regional or Satellite Office Director’s letter, then an elective referral will be sent by the Regional or Satellite Office Director or designee to the Department Enforcement Center (DEC), and the owner must be flagged in the Active Partners Participation System (APPS).

2. A complainant who disagrees with the decision of “no reasonable cause” from the Regional or Satellite Office Director can request reconsideration of the case by sending a letter to the Director of the Office of Asset Management and Portfolio Oversight, 451 7th Street, SW, Room 6180, Washington, DC 20410.

   a. Upon receipt of a request for reconsideration, the Office of Asset Management and Portfolio Oversight (OAMPO) will notify all of the parties that the request has been received and invite them to submit any additional evidence pertinent to the investigation.

   b. OAMPO will review all of the materials from the investigation and any additional evidence that the parties provide and make a final determination.

   c. If the OAMPO determination results in a finding of reasonable cause HUD will issue a determination of "reasonable cause", which will include an explanation of the basis for the determination, and pursue the enforcement remedies described in Section E herein. HUD will send a copy of the charge to each party in the case.

G. Paperwork Reduction Act

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control numbers 2502-0324 and 2502-0601. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

If you have questions regarding this Housing Notice, you may contact your Account Executive in the Field Asset Management Division, Office of Asset Management and Portfolio Oversight, Headquarters.

Edward P. Golding
Principal Deputy Assistant Secretary for Housing

8
HUD Guidelines on use of Criminal Records
I. Introduction

The Fair Housing Act (or Act) prohibits discrimination in the sale, rental, or financing of dwellings and in other housing-related activities on the basis of race, color, religion, sex, disability, familial status or national origin. HUD's Office of General Counsel issues this guidance concerning how the Fair Housing Act applies to the use of criminal history by providers or operators of housing and real-estate related transactions. Specifically, this guidance addresses how the discriminatory effects and disparate treatment methods of proof apply in Fair Housing Act cases in which a housing provider justifies an adverse housing action — such as a refusal to rent or renew a lease — based on an individual's criminal history.

II. Background

As many as 100 million U.S. adults — or nearly one-third of the population — have a criminal record of some sort. The United States prison population of 2.2 million adults is by far the largest in the world. As of 2012, the United States accounted for only about five percent of the world's population, yet almost one quarter of the world’s prisoners were held in American prisons. Since 2004, an average of over 650,000 individuals have been released annually from federal and state prisons, and over 95 percent of current inmates will be released at some point. When individuals are released from prisons and jails, their ability to access safe, secure and affordable housing is critical to their successful reentry to society. Yet many formerly incarcerated individuals, as well as individuals who were convicted but not incarcerated, encounter significant barriers to securing housing, including public and other federally-subsidized housing,

1 42 U.S.C. § 3601 et seq.
4 Id.
because of their criminal history. In some cases, even individuals who were arrested but not convicted face difficulty in securing housing based on their prior arrest.

Across the United States, African Americans and Hispanics are arrested, convicted and incarcerated at rates disproportionate to their share of the general population. Consequently, criminal records-based barriers to housing are likely to have a disproportionate impact on minority home seekers. While having a criminal record is not a protected characteristic under the Fair Housing Act, criminal history-based restrictions on housing opportunities violate the Act if, without justification, their burden falls more often on renters or other housing market participants of one race or national origin over another (i.e., discriminatory effects liability). Additionally, intentional discrimination in violation of the Act occurs if a housing provider treats individuals with comparable criminal history differently because of their race, national origin or other protected characteristic (i.e., disparate treatment liability).

III. Discriminatory Effects Liability and Use of Criminal History to Make Housing Decisions

A housing provider violates the Fair Housing Act when the provider’s policy or practice has an unjustified discriminatory effect, even when the provider had no intent to discriminate. Under this standard, a facially-neutral policy or practice that has a discriminatory effect violates the Act if it is not supported by a legally sufficient justification. Thus, where a policy or practice that restricts access to housing on the basis of criminal history has a disparate impact on individuals of a particular race, national origin, or other protected class, such policy or practice is unlawful under the Fair Housing Act if it is not necessary to serve a substantial, legitimate, nondiscriminatory interest of the housing provider, or if such interest could be served by another practice that has a less discriminatory effect. Discriminatory effects liability is assessed under a three-step burden-shifting standard requiring a fact-specific analysis.

The following sections discuss the three steps used to analyze claims that a housing provider’s use of criminal history to deny housing opportunities results in a discriminatory effect in violation of the Act. As explained in Section IV, below, a different analytical framework is used to evaluate claims of intentional discrimination.

---

8 See infra nn. 16-20 and accompanying text.
9 The Fair Housing Act prohibits discrimination based on race, color, religion, sex, disability, familial status, and national origin. This memorandum focuses on race and national origin discrimination, although criminal history policies may result in discrimination against other protected classes.
11 24 C.F.R. § 100.500; see also Inclusive Cmtys. Project, 135 S. Ct. at 2514-15 (summarizing HUD’s Discriminatory Effects Standard in 24 C.F.R. § 100.500); id. at 2523 (explaining that housing providers may maintain a policy that causes a disparate impact “if they can prove [the policy] is necessary to achieve a valid interest.”).
12 See 24 C.F.R. § 100.500.
A. Evaluating Whether the Criminal History Policy or Practice Has a Discriminatory Effect

In the first step of the analysis, a plaintiff (or HUD in an administrative adjudication) must prove that the criminal history policy has a discriminatory effect, that is, that the policy results in a disparate impact on a group of persons because of their race or national origin. This burden is satisfied by presenting evidence proving that the challenged practice actually or predictably results in a disparate impact.

Whether national or local statistical evidence should be used to evaluate a discriminatory effects claim at the first step of the analysis depends on the nature of the claim alleged and the facts of that case. While state or local statistics should be presented where available and appropriate based on a housing provider's market area or other facts particular to a given case, national statistics on racial and ethnic disparities in the criminal justice system may be used where, for example, state or local statistics are not readily available and there is no reason to believe they would differ markedly from the national statistics.

National statistics provide grounds for HUD to investigate complaints challenging criminal history policies. Nationally, racial and ethnic minorities face disproportionately high rates of arrest and incarceration. For example, in 2013, African Americans were arrested at a rate more than double their proportion of the general population. Moreover, in 2014, African Americans comprised approximately 36 percent of the total prison population in the United States, but only about 12 percent of the country's total population. In other words, African Americans were incarcerated at a rate nearly three times their proportion of the general population. Hispanics were similarly incarcerated at a rate disproportionate to their share of the population.

13 24 C.F.R. § 100.500(c)(1); accord Inclusive Cmty. Project, 135 S. Ct. at 2522-23. A discriminatory effect can also be proven with evidence that the policy or practice creates, increases, reinforces, or perpetuates segregated housing patterns. See 24 C.F.R. § 100.500(a). This guidance addresses only the method for analyzing disparate impact claims, which in HUD's experience are more commonly asserted in this context.

14 Compare Dothard v. Rawlinson, 433 U.S. 321,330 (1977) ("[R]eliance on general population demographic data was not misplaced where there was no reason to suppose that physical height and weight characteristics of Alabama men and women differ markedly from those of the national population.") with Mountain Side Mobile Estates P' ship v. Sec'y of Hous. & Urban Dev., 56 F.3d 1243, 1253 (10th Cir. 1995) ("In some cases national statistics may be the appropriate comparable population. However, those cases are the rare exception and this case is not such an exception.") (citation omitted).

15 Cf. El v. SEPTA, 418 F. Supp. 2d 659, 669-69 (E.D. Pa. 2005) (finding that plaintiff proved prima facie case of disparate impact under Title VII based on national data from the U.S. Bureau of Justice Statistics and the Statistical Abstract of the U.S., which showed that non-Whites were substantially more likely than Whites to have a conviction), aff'd on other grounds, 479 F.2d 232 (3d Cir. 2007).


general population, with Hispanic individuals comprising approximately 22 percent of the prison population, but only about 17 percent of the total U.S. population.18 In contrast, non-Hispanic Whites comprised approximately 62 percent of the total U.S. population but only about 34 percent of the prison population in 2014.19 Across all age groups, the imprisonment rates for African American males is almost six times greater than for White males, and for Hispanic males, it is over twice that for non-Hispanic White males.20

Additional evidence, such as applicant data, tenant files, census demographic data and localized criminal justice data, may be relevant in determining whether local statistics are consistent with national statistics and whether there is reasonable cause to believe that the challenged policy or practice causes a disparate impact. Whether in the context of an investigation or administrative enforcement action by HUD or private litigation, a housing provider may offer evidence to refute the claim that its policy or practice causes a disparate impact on one or more protected classes.

Regardless of the data used, determining whether a policy or practice results in a disparate impact is ultimately a fact-specific and case-specific inquiry.

B. Evaluating Whether the Challenged Policy or Practice is Necessary to Achieve a Substantial, Legitimate, Non-discriminatory Interest

In the second step of the discriminatory effects analysis, the burden shifts to the housing provider to prove that the challenged policy or practice is justified — that is, that it is necessary to achieve a substantial, legitimate, nondiscriminatory interest of the provider.21 The interest proffered by the housing provider may not be hypothetical or speculative, meaning the housing provider must be able to provide evidence proving both that the housing provider has a substantial, legitimate, nondiscriminatory interest supporting the challenged policy and that the challenged policy actually achieves that interest.22

Although the specific interest(s) that underlie a criminal history policy or practice will no doubt vary from case to case, some landlords and property managers have asserted the protection of other residents and their property as the reason for such policies or practices.23 Ensuring

---

18 See id.
19 See id.
21 24 C.F.R. § 100.500(c)(2); see also Inclusive Cmtys. Project, 135 S. Ct. at 2523.
22 See 24 C.F.R. § 100.500(b)(2); see also 78 Fed. Reg. 11460, 11471 (Feb. 15, 2013).
23 See, e.g., Answer to Amended Complaint at 58, The Fortune Society, Inc. v. Sandcastle Towers Hsg. Dev. Fund Corp., No. 1:14-CV-6410 (E.D.N.Y. May 21, 2015), ECF No. 37 (“The use of criminal records searches as part of the overall tenant screening process used at Sand Castle serves valid business and security functions of protecting tenants and the property from former convicted criminals.”); Evans v. UDR, Inc., 644 F.Supp.2d 675, 683 (E.D.N.C. 2009) (noting, based on affidavit of property owner, that “[t]he policy [against renting to individuals with criminal histories is] based primarily on the concern that individuals with criminal histories are more likely than others to commit crimes on the property than those without such backgrounds ... [and] is thus based [on] concerns for the safety of other residents of the apartment complex and their property.”); see also J. Helfgott, Ex-Offender Needs Versus Community Opportunity in Seattle, Washington, 61 Fed. Probation 12, 20 (1997) (finding in a survey of 196
resident safety and protecting property are often considered to be among the fundamental responsibilities of a housing provider, and courts may consider such interests to be both substantial and legitimate, assuming they are the actual reasons for the policy or practice.\textsuperscript{24} A housing provider must, however, be able to prove through reliable evidence that its policy or practice of making housing decisions based on criminal history actually assists in protecting resident safety and/or property. Bald assertions based on generalizations or stereotypes that any individual with an arrest or conviction record poses a greater risk than any individual without such a record are not sufficient to satisfy this burden.

1. Exclusions Because of Prior Arrest

A housing provider with a policy or practice of excluding individuals because of one or more prior arrests (without any conviction) cannot satisfy its burden of showing that such policy or practice is necessary to achieve a substantial, legitimate, nondiscriminatory interest.\textsuperscript{25} As the Supreme Court has recognized, “[t]he mere fact that a man has been arrested has very little, if any, probative value in showing that he has engaged in any misconduct. An arrest shows nothing more than that someone probably suspected the person apprehended of an offense.”\textsuperscript{26} Because arrest records do not constitute proof of past unlawful conduct and are often incomplete (e.g., by failing to indicate whether the individual was prosecuted, convicted, or acquitted),\textsuperscript{27} the fact of an arrest is not a reliable basis upon which to assess the potential risk to resident safety or property posed by a particular individual. For that reason, a housing provider who denies housing to persons on the basis of arrests not resulting in conviction cannot prove that the exclusion actually assists in protecting resident safety and/or property.

\textsuperscript{24} As explained in HUD’s 2013 Discriminatory Effects Final Rule, a “substantial” interest is a core interest of the organization that has a direct relationship to the function of that organization. The requirement that an interest be “legitimate” means that a housing provider’s justification must be genuine and not false or fabricated. See 78 Fed. Reg. at 11470; see also Charleston Hous. Auth. v. U.S. Dep’t of Agric., 419 F.3d 729, 742 (8th Cir. 2005) (recognizing that, “in the abstract, a reduction in the concentration of low income housing is a legitimate goal,” but concluding “that the Housing Authority had not shown a need for deconcentration in this instance, and in fact, had falsely represented the density [of low income housing] at the location in question in an attempt to do so”).


\textsuperscript{26} Schware v. Bd of Bar Examiners, 353 U.S. 232, 241 (1957); see also United States v. Berry, 553 F.3d 273, 282 (3d Cir. 2009) (“A bare arrest record – without more – does not justify an assumption that a defendant has committed other crimes and it therefore cannot support increasing his/her sentence in the absence of adequate proof of criminal activity.”); United States v. Zapete-Garcia, 447 F.3d 57, 60 (1st Cir. 2006) (“A mere arrest, especially a lone arrest, is not evidence that the person arrested actually committed any criminal conduct.”).

\textsuperscript{27} See, e.g., U.S. Dep’t of Justice, The Attorney General’s Report on Criminal History Background Checks at 3, 17 (June 2006), available at http://www.bjs.gov/content/pub/pdf/ag_bechcks_report.pdf (reporting that the FBI’s Interstate Identification Index system, which is the national system designed to provide automated criminal history record information and “the most comprehensive single source of criminal history information in the United States,” is “still missing final disposition information for approximately 50 percent of its records”).
Analogously, in the employment context, the Equal Employment Opportunity Commission has explained that barring applicants from employment on the basis of arrests not resulting in conviction is not consistent with business necessity under Title VII because the fact of an arrest does not establish that criminal conduct occurred.\(^{28}\)

2. **Exclusions Because of Prior Conviction**

In most instances, a record of conviction (as opposed to an arrest) will serve as sufficient evidence to prove that an individual engaged in criminal conduct.\(^{29}\) But housing providers that apply a policy or practice that excludes persons with prior convictions must still be able to prove that such policy or practice is necessary to achieve a substantial, legitimate, nondiscriminatory interest. A housing provider that imposes a blanket prohibition on any person with any conviction record—no matter when the conviction occurred, what the underlying conduct entailed, or what the convicted person has done since then—will be unable to meet this burden. One federal court of appeals held that such a blanket ban violated Title VII, stating that it “could not conceive of any business necessity that would automatically place every individual convicted of any offense, except a minor traffic offense, in the permanent ranks of the unemployed.”\(^{30}\) Although the defendant-employer in that case had proffered a number of theft and safety-related justifications for the policy, the court rejected such justifications as “not empirically validated.”\(^{31}\)

A housing provider with a more tailored policy or practice that excludes individuals with only certain types of convictions must still prove that its policy is necessary to serve a “substantial, legitimate, nondiscriminatory interest.” To do this, a housing provider must show that its policy accurately distinguishes between criminal conduct that indicates a demonstrable risk to resident safety and/or property and criminal conduct that does not.\(^{32}\)

---

\(^{28}\) See U.S. Equal Emp’t Opportunity Comm’n, EEOC Enforcement Guidance, Number 915.002, 12 (Apr. 25, 2012), available at http://www.eeoc.gov/laws/guidance/arrest_conviction.cfm; see also Gregory v. Litton Systems, Inc., 316 F. Supp. 401, 403 (C.D. Cal. 1970) (holding that defendant employer’s policy of excluding from employment persons with arrests without convictions unlawfully discriminated against African American applicants in violation of Title VII because there “was no evidence to support a claim that persons who have suffered no criminal convictions but have been arrested on a number of occasions can be expected, when employed, to perform less efficiently or less honestly than other employees,” such that “information concerning a … record of arrests without conviction, is irrelevant to [an applicant’s] suitability or qualification for employment”), aff’d, 472 F.2d 631 (9th Cir. 1972).

\(^{29}\) There may, however, be evidence of an error in the record, an outdated record, or another reason for not relying on the evidence of a conviction. For example, a database may continue to report a conviction that was later expunged, or may continue to report as a felony an offense that was subsequently downgraded to a misdemeanor. See generally SEARCH, Report of the National Task Force on the Commercial Sale of Criminal Justice Record Information (2005), available at http://www.search.org/files/pdf/RNTFSCJRI.pdf.

\(^{30}\) Green v. Missouri Pacific R.R., 523 F.2d 1290, 1298 (8th Cir. 1975).

\(^{31}\) Id.

\(^{32}\) Cf. El, 479 F.3d at 245-46 (stating that “Title VII … require[s] that the [criminal conviction] policy under review accurately distinguish[es] between applicants that pose an unacceptable level or risk and those that do not”).
A policy or practice that fails to take into account the nature and severity of an individual’s conviction is unlikely to satisfy this standard. Similarly, a policy or practice that does not consider the amount of time that has passed since the criminal conduct occurred is unlikely to satisfy this standard, especially in light of criminological research showing that, over time, the likelihood that a person with a prior criminal record will engage in additional criminal conduct decreases until it approximates the likelihood that a person with no criminal history will commit an offense.

Accordingly, a policy or practice that fails to consider the nature, severity, and recency of criminal conduct is unlikely to be proven necessary to serve a “substantial, legitimate, nondiscriminatory interest” of the provider. The determination of whether any particular criminal history-based restriction on housing satisfies step two of the discriminatory effects standard must be made on a case-by-case basis.

C. Evaluating Whether There Is a Less Discriminatory Alternative

The third step of the discriminatory effects analysis is applicable only if a housing provider successfully proves that its criminal history policy or practice is necessary to achieve its substantial, legitimate, nondiscriminatory interest. In the third step, the burden shifts back to the plaintiff or HUD to prove that such interest could be served by another practice that has a less discriminatory effect.

Although the identification of a less discriminatory alternative will depend on the particulars of the criminal history policy or practice under challenge, individualized assessment of relevant mitigating information beyond that contained in an individual’s criminal record is likely to have a less discriminatory effect than categorical exclusions that do not take such additional information into account. Relevant individualized evidence might include: the facts or circumstances surrounding the criminal conduct; the age of the individual at the time of the conduct; evidence that the individual has maintained a good tenant history before and/or after the conviction or conduct; and evidence of rehabilitation efforts. By delaying consideration of criminal history until after an individual’s financial and other qualifications are verified, a housing provider may be able to minimize any additional costs that such individualized assessment might add to the applicant screening process.

33 Cf. Green, 523 F.2d at 1298 (holding that racially disproportionate denial of employment opportunities based on criminal conduct that “does not significantly bear upon the particular job requirements is an unnecessarily harsh and unjust burden” and violated Title VII).
34 Cf. El, 479 F.3d at 247 (noting that plaintiff’s Title VII disparate impact claim might have survived summary judgment had plaintiff presented evidence that “there is a time at which a former criminal is no longer any more likely to recidivate than the average person...”); see also Green, 523 F.2d at 1298 (permanent exclusion from employment based on any and all offenses violated Title VII); see Megan C. Kurlychek et al., Scarlet Letters and Recidivism: Does an Old Criminal Record Predict Future Offending?, 5 Criminology and Pub. Pol’y 483 (2006) (reporting that after six or seven years without reoffending, the risk of new offenses by persons with a prior criminal history begins to approximate the risk of new offenses among persons with no criminal record).
35 The liability standards and principles discussed throughout this guidance would apply to HUD-assisted housing providers just as they would to any other housing provider covered by the Fair Housing Act. See HUD PIH Notice 2015-19 supra n. 25. Section 6 of that Notice addresses civil rights requirements.
36 24 C.F.R. § 100.500(c)(3); accord Inclusive Cmty. Project, 135 S. Ct. 2507.
D. Statutory Exemption from Fair Housing Act Liability for Exclusion Because of Illegal Manufacture or Distribution of a Controlled Substance

Section 807(b)(4) of the Fair Housing Act provides that the Act does not prohibit “conduct against a person because such person has been convicted … of the illegal manufacture or distribution of a controlled substance as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802).” Accordingly, a housing provider will not be liable under the Act for excluding individuals because they have been convicted of one or more of the specified drug crimes, regardless of any discriminatory effect that may result from such a policy.

Limitation. Section 807(b)(4) only applies to disparate impact claims based on the denial of housing due to the person’s conviction for drug manufacturing or distribution; it does not provide a defense to disparate impact claims alleging that a policy or practice denies housing because of the person’s arrest for such offenses. Similarly, the exemption is limited to disparate impact claims based on drug manufacturing or distribution convictions, and does not provide a defense to disparate impact claims based on other drug-related convictions, such as the denial of housing due to a person’s conviction for drug possession.

IV. Intentional Discrimination and Use of Criminal History

A housing provider may also violate the Fair Housing Act if the housing provider intentionally discriminates in using criminal history information. This occurs when the provider treats an applicant or renter differently because of race, national origin or another protected characteristic. In these cases, the housing provider’s use of criminal records or other criminal history information as a pretext for unequal treatment of individuals because of race, national origin or other protected characteristics is no different from the discriminatory application of any other rental or purchase criteria.

For example, intentional discrimination in violation of the Act may be proven based on evidence that a housing provider rejected an Hispanic applicant based on his criminal record, but admitted a non-Hispanic White applicant with a comparable criminal record. Similarly, if a housing provider has a policy of not renting to persons with certain convictions, but makes exceptions to it for Whites but not African Americans, intentional discrimination exists. A disparate treatment violation may also be proven based on evidence that a leasing agent assisted a White applicant seeking to secure approval of his rental application despite his potentially disqualifying criminal record under the housing provider’s screening policy, but did not provide such assistance to an African American applicant.

38 Cf. Sherman Ave. Tenants’ Assn. v. District of Columbia, 444 F.3d 673, 683-84 (D.C. Cir. 2006) (upholding plaintiff’s disparate treatment claim based on evidence that defendant had not enforced its housing code as aggressively against comparable non-Hispanic neighborhoods as it did in plaintiff’s disproportionately Hispanic neighborhood).
39 See, e.g., Muriello, 217 F. 3d at 522 (holding that Plaintiff’s allegations that his application for federal housing assistance and the alleged existence of a potentially disqualifying prior criminal record was handled differently than those of two similarly situated white applicants presented a prima facie case that he was discriminated against because of race, in violation of the Fair Housing Act).
Discrimination may also occur before an individual applies for housing. For example, intentional discrimination may be proven based on evidence that, when responding to inquiries from prospective applicants, a property manager told an African American individual that her criminal record would disqualify her from renting an apartment, but did not similarly discourage a White individual with a comparable criminal record from applying.

If overt, direct evidence of discrimination does not exist, the traditional burden-shifting method of establishing intentional discrimination applies to complaints alleging discriminatory intent in the use of criminal history information. First, the evidence must establish a prima facie case of disparate treatment. This may be shown in a refusal to rent case, for example, by evidence that: (1) the plaintiff (or complainant in an administrative enforcement action) is a member of a protected class; (2) the plaintiff or complainant applied for a dwelling from the housing provider; (3) the housing provider rejected the plaintiff or complainant because of his or her criminal history; and (4) the housing provider offered housing to a similarly-situated applicant not of the plaintiff or complainant’s protected class, but with a comparable criminal record. It is then the housing provider’s burden to offer “evidence of a legitimate, nondiscriminatory reason for the adverse housing decision.” A housing provider’s nondiscriminatory reason for the challenged decision must be clear, reasonably specific, and supported by admissible evidence. Purely subjective or arbitrary reasons will not be sufficient to demonstrate a legitimate, nondiscriminatory basis for differential treatment.

While a criminal record can constitute a legitimate, nondiscriminatory reason for a refusal to rent or other adverse action by a housing provider, a plaintiff or HUD may still prevail by showing that the criminal record was not the true reason for the adverse housing decision, and was instead a mere pretext for unlawful discrimination. For example, the fact that a housing provider acted upon comparable criminal history information differently for one or more individuals of a different protected class than the plaintiff or complainant is strong evidence that a housing provider was not considering criminal history information uniformly or did not in fact have a criminal history policy. Or pretext may be shown where a housing provider did not actually know of an applicant’s criminal record at the time of the alleged discrimination. Additionally, shifting or inconsistent explanations offered by a housing provider for the denial of an application may also provide evidence of pretext. Ultimately, the evidence that may be offered to show that the plaintiff or complainant’s criminal history was merely a pretextual

---

40 See, generally, McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973) (articulating the concept of a “prima facie case” of intentional discrimination under Title VII); see, e.g., Allen v. Muriello, 217 F. 3rd 517, 520-22 (7th Cir. 2000) (applying prima facie case analysis to claim under the Fair Housing Act alleging disparate treatment because of race in housing provider’s use of criminal records to deny housing).
41 Lindsay v. Yates, 578 F.3d 407, 415 (6th Cir. 2009) (quotations and citations omitted).
42 See, e.g., Robinson v. 12 Lofts Realty, Inc., 610 F.2d 1032, 1039-40 (2d Cir. 1979) (“A prima facie case having been established, a Fair Housing Act claim cannot be defeated by a defendant which relies on merely hypothetical reasons for the plaintiff’s rejection.”).
43 See, e.g., Muriello, 217 F.3d at 522 (noting that housing provider’s “rather dubious explanation for the differing treatment” of African American and White applicants’ criminal records “puts the issue of pretext in the lap of a trier of fact”); Soules v. U.S. Dept’ of Hous. and Urban Dev., 967 F.2d 817, 822 (2d Cir. 1992) (“In examining the defendant’s reason, we view skeptically subjective rationales concerning why he denied housing to members or protected groups [because] ‘clever men may easily conceal their [discriminatory] motivations.’” (quoting United States v. City of Black Jack, Missouri, 508 F.2d 1179, 1185 (8th Cir. 1974)).
justification for intentional discrimination by the housing provider will depend on the facts of a particular case.

The section 807(b)(4) exemption discussed in Section III.D., above, does not apply to claims of intentional discrimination because by definition, the challenged conduct in intentional discrimination cases is taken because of race, national origin, or another protected characteristic, and not because of the drug conviction. For example, the section 807(b)(4) exemption would not provide a defense to a claim of intentional discrimination where the evidence shows that a housing provider rejects only African American applicants with convictions for distribution of a controlled substance, while admitting White applicants with such convictions.

V. Conclusion

The Fair Housing Act prohibits both intentional housing discrimination and housing practices that have an unjustified discriminatory effect because of race, national origin or other protected characteristics. Because of widespread racial and ethnic disparities in the U.S. criminal justice system, criminal history-based restrictions on access to housing are likely disproportionately to burden African Americans and Hispanics. While the Act does not prohibit housing providers from appropriately considering criminal history information when making housing decisions, arbitrary and overbroad criminal history-related bans are likely to lack a legally sufficient justification. Thus, a discriminatory effect resulting from a policy or practice that denies housing to anyone with a prior arrest or any kind of criminal conviction cannot be justified, and therefore such a practice would violate the Fair Housing Act.

Policies that exclude persons based on criminal history must be tailored to serve the housing provider's substantial, legitimate, nondiscriminatory interest and take into consideration such factors as the type of the crime and the length of the time since conviction. Where a policy or practice excludes individuals with only certain types of convictions, a housing provider will still bear the burden of proving that any discriminatory effect caused by such policy or practice is justified. Such a determination must be made on a case-by-case basis.

Selective use of criminal history as a pretext for unequal treatment of individuals based on race, national origin, or other protected characteristics violates the Act.

Helen R. Kanovsky, General Counsel
HUD Notice for new Benchmarking Rules
Subject: HUD Energy Benchmarking Notice Published Today

Dear Multifamily Partners:

Multifamily Housing published a notice today allowing for 60 days of public comments on requiring energy benchmarking reporting for properties with Project Rental Assistance Contracts, Housing Assistance Payment contracts, and multifamily properties that are already or about to be FHA insured. Benchmarking will allow property owners to make data-driven decisions, resulting in reduced operating costs and improved performance over time.
The notice aligns with both the President’s Climate Action Plan as well as HUD’s commitment to creating energy and water-efficient housing. These efficiency investments pay such dividends as improving occupant comfort; stabilizing operating costs; alleviating taxpayer burden; preserving affordable housing; ensuring disaster resilience; and mitigating climate change.

Covered properties for this reporting requirement include:

- Section 202 Project Rental Assistance Contracts (PRAC)
- Section 811 PRAC and Project Rental Assistance contracts
- Section 202/162 Project Assistance Contracts
- Section 202 Senior Preservation Rental Assistance Contracts
- Section 8 Housing Assistance Payment contracts
- Multifamily Housing properties insured under Sections 223(a)(7), 223(f), 221(d)(3) 221(d)(4), 220, 231, 236, and 241(a).

Owners of covered properties are encouraged to voluntarily submit water and energy benchmarking data to HUD on an annual basis. HUD will require that owners submit benchmarking information on the following schedule, subject to revision:

- For HUD-assisted properties with a utility allowance, at the time of a triennial utility allowance baseline calculation;
- For HUD-assisted properties where there is no utility allowance, every third year at the time of financial statement submission;
- Prior to issuance of new FHA mortgage insurance under Sections 223(a)(7), 223(f), and 241(a);
- With a Capital Needs Assessment submission required by the Office of Asset Management and Portfolio Oversight in HUD’s Office of Multifamily Housing Programs on a 10-year cycle;
- With a Capital Needs Assessment submission required as part of any enforcement action.

Only properties that have been in existence for at least 12 months and that include 21 housing units or more are eligible to receive an ENERGY STAR Score so these two metrics will not be required for ineligible properties. Properties with less than 21 units are encouraged to submit data although not required.

Owners seeking a covered property transaction will be required to enter data into ENERGY STAR Portfolio Manager and electronically submit to HUD the referenced metrics created by the free web tool.

HUD has dedicated technical assistance resources to help owners collect, track, and analyze energy data. This includes building a website with tools, case studies, and links to federal resources.

The utility benchmarking requirement will apply when executing any covered transaction beginning 90 days after OMB approval of the PRA request, and not sooner than April 15, 2017. The first scheduled submission date for a majority of assisted-housing respondents is estimated to occur in 2019.
Multifamily Housing will finalize the timing and requirements in a forthcoming Housing Notice that will be published after this notice is approved.

Access the notice here, and through the Multifamily homepage under “What’s New.” Questions should be directed to Stan Houle.

Also, click on the image below to access our latest newsletter that focuses on energy and water efficiency and includes a benchmarking article.

Thank you for your attention.

Multifamily Communications Team

Multifamily Housing Programs
Proposed new FHA rules
general population, or should they include those nutrients that contribute to general overall health? Should the nutrients be intrinsic to the foods, or could they be provided in part—or in total—via fortification? Please provide details of your reasoning and provide any supportive data or information.

- Are there current dietary recommendations (e.g., the Dietary Guidelines for Americans) or nutrient intake requirements, such as those described in the final rule updating the Nutrition Facts label (see 81 FR 32742; May 27, 2016) or those provided by the Institute of Medicine (IOM) in the form of Dietary Reference Intakes (DRI) (http://www.nationalacademies.org/hmd/Activities/Nutrition/SummaryDRIs/DRI-Tables.aspx), that should be reflected in criteria for use of the term “healthy”?
- What are the public health benefits, if any, of defining the term “healthy” or other similar terms in food labeling? Please include any data or research related to public health benefits in your reasoning.
- What is consumers’ understanding of the meaning of the term “healthy” as it relates to food? What are consumers’ expectations of foods that carry a “healthy” claim? We are especially interested in any data or other information that evaluates whether or not consumers associate, confuse, or compare the term “healthy” with other descriptive terms and claims.
- Would this change in the term “healthy” cause a shift in consumer behavior in terms of dietary choices? For example, would it cause a shift away from purchasing or consuming fruits and vegetables that do not contain a “healthy” claim and towards purchasing or consuming processed foods that bear this new “healthy” claim?
- How will the food industry and consumers regard a change in the definition of “healthy”?
- What would be the costs to industry of the change?

Please provide supporting data, consumer research, and other information to support your comments and responses to these questions.

III. References

The following reference is on display in the Division of Dockets Management (see ADDRESSES) and is available for viewing by interested persons between 9 a.m. and 4 p.m., Monday through Friday; it is also available electronically at http://www.regulations.gov. (FDA has verified the Web site address, as of the date this document publishes in the Federal Register, but Web sites are subject to change over time.)


Leslie Kux,
Associate Commissioner for Policy.
[FR Doc. 2016–23365 Filed 9–27–16; 8:45 am]
BILLING CODE 4164–01–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
24 CFR Parts 203 and 234
[Docket No. FR–5715–P–01]
RIN 2502–AJ30
Project Approval for Single-Family Condominiums

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: This proposed rule would implement HUD’s authority under the single-family mortgage insurance provisions of the National Housing Act to insure one-family units in a multifamily project, including a project in which the dwelling units are attached, or are manufactured housing units, semi-detached, or detached, and an undivided interest in the common areas and facilities which serve the project. The rule would codify requirements for Direct Endorsement lenders to meet in order to be approved for the Direct Endorsement Lender Review and Approval Process (DELRAP) authority for condominiums, and basic standards that projects must meet to be approved as condominiums in which individual units would be eligible for mortgage insurance, as well as particular cases such as Single-Unit Approvals and site condominiums. The rule provides a method by which certain approval standards could be varied efficiently to meet market needs while providing for public comment where appropriate. Currently, single-family condominium project approval is provided under HUD’s Condominium Project Approval and Processing Guide and related Mortgagee Letters.

Condominiums under this rule are distinct from condominiums in which the project has a blanket mortgage insured by HUD.

DATES: Comment due date: November 28, 2016.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW., Room 10276, Washington, DC 20410–0500. Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street SW., Room 10276, Washington, DC 20410–0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HMD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

No Facsimile Comments. Facsimile (fax) comments are not acceptable.

Public Inspection of Public Comments. HUD will make all properly submitted comments and communications available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, you must schedule an appointment in advance to review the public comments by calling the Regulations Division at 202–708–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the toll-free Federal Relay Service at 800–877–8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

Under proposed § 203.8(b)(2) and (b)(3), mortgagees would initially be granted conditional DELRAP authority upon providing a notice of their intent to participate in DELRAP. While conditionally approved, a mortgagee must submit all recommended Condominium Project approvals and denials to FHA for review, and may only proceed upon notification of HUD’s agreement with the recommendation. Once the mortgagee has completed at least 5 DELRAP reviews to HUD’s satisfaction, the mortgagee will be granted unconditional DELRAP authority and may approve condominium projects in accordance with HUD’s requirements.

Section 203.8(c) would provide for HUD’s review of a DELRAP mortgagee’s performance. HUD will monitor the performance on an ongoing basis, and, if there are no material deficiencies found, HUD will select a sample of project approvals, denials, or recertifications for post-action review. If the review shows deficiencies and the mortgagee has unconditional DELRAP authority, the mortgagee may be returned to conditional status. If additional reviews continue to show deficiencies, the mortgagee may be permitted, or other action taken against the staff reviewer, under proposed § 203.8(d), which includes any action available under 24 CFR 203.3(d).

Sections 203.8(d) and (e) provide for termination of DELRAP authority and requests for reinstatement of terminated authority. HUD may immediately terminate DELRAP authority or take actions under § 203.3(d) if the mortgagee violates any of the requirements and procedures established by the Secretary for mortgagees approved to participate in DELRAP, the Direct Endorsement program, or the Title II Single Family mortgage insurance program; or if other good cause exists; or for unacceptable performance. Actions under 24 CFR 203.3(d) include probation of Direct Endorsement lenders subject to conditions including additional training and changes to the mortgagee’s quality control plan, or termination of Direct Endorsement approval. Termination of DELRAP authority would be effective upon the mortgagee’s receipt of HUD’s notice advising of the termination. Any termination of DELRAP authority is a separate action from an action for withdrawal of mortgage approval by the Mortgagee Review Board, which could also be initiated by HUD.

Under proposed § 203.8(e), a mortgagee whose DELRAP authority is terminated under this section may request reinstatement if the mortgagee’s
DELRAP authority has been terminated for at least 6 months. The request must address the eligibility criteria for participation in DELRAP under this rule as well as a corrective action plan, along with evidence that the mortgagee has implemented the corrective action plan. Following the request, HUD would be able to grant Conditional DELRAP authority if the mortgagee’s application is complete and the Commissioner determines that the underlying causes for the termination have been satisfactorily remedied. The mortgagee would be required to complete successfully at least 5 test cases in accordance with § 203.8(b)(3) in order to receive unconditional DELRAP authority.

The rule proposes a minor change to current § 203.17(a)(1), which section defines “mortgage” in accordance with section 201 of the National Housing Act (12 U.S.C. 1707), but has not been updated to account for the addition of mortgages on one-family units in multifamily projects and an undivided interest in the common areas and facilities. The current regulatory definition include detached and semi-attached units. By revising this section to cross-reference section 201 of the National Housing Act rather than attempting to summarize it, HUD avoids the need to update this definition each time the statutory definition is revised, and eliminates confusion that may be caused by differences between the statutory language and HUD’s regulation.

This rule proposes to revise currently reserved § 203.43b to include the regulations pertaining to the eligibility of projects for approval and for condominium units in approved projects for mortgage insurance. Section 203.43b(a) would provide definitions of the terms Condominium Project, Condominium Unit, Rental for Transient or Hotel Purposes, Condominium Association, Single-Unit Approval, and Site Condominium under part 203. While Condominium Unit refers to a one-family unit in a multifamily project, including a project in which the dwelling units are attached, or are manufactured housing units, semi-detached, or detached, and an undivided interest in the common areas and facilities that serve the project, the term Condominium Project refers to the project as a whole in which such units are located. The term Rental for Transient or Hotel Purposes cross-references to section 513(e) of the Act (12 U.S.C. 1731b(e)). Single-Unit Approval means approval of a loan on a single unit in a project that is not approved as a condominium. The term Site Condominium means a single family totally detached dwelling (which does not have a shared garage or any other attached building, including such improvements as archways, or breezeways), which is encumbered by a declaration of condominium covenants or condominium form of ownership, and which consists of the entire structure as well as the site and air space and is not considered to be a common area or limited common area.

Section 203.43b(b) would state that a mortgage on a Condominium Unit shall be eligible for insurance under section 203 of the National Housing Act if it meets the requirements of 24 CFR part 203, subpart A, except as provided for in § 203.43b. Section 203.43b(c) would further specify that the unit, to be eligible for insurance under § 203.43b, must be located in a Condominium Project approved by HUD or DELRAP mortgagee approved under 24 CFR part 203.8, or meet the additional requirements for approval as a Site Condominium or Single-Unit Approval. Under this rule, HUD and DELRAP lenders will not approve proposed or under construction projects; however, HUD or DELRAP lenders may approve legal phases of projects or completed projects. The condominiums that may be approved under this rule would be those where the work on the project or legal phase, including buildings and infrastructure of the project or legal phase, is fully complete. HUD would expect that all the requirements of local law would be met, including review and approval of the project or legal phase by the local jurisdiction, coordination in the property records of the condominium plat or development plan, as applicable (see §§ 203.43b(d)(4) and (d)(5)).

Section 203.43b(d) would state the basic condominium project approval eligibility requirements. The project or legal phase must be complete as to construction of the buildings and infrastructure. In addition, any legal phases must be contiguous (in a vertical building) or must consist of adjoining or contiguous buildings (detached or semi-detached homes), and the units or buildings and infrastructure in each phase must be constructed and be complete. The project or legal phase must also be primarily residential in nature (although a certain amount of floor space may be set aside for commercial activities, as stated at § 203.43b(d)(6)(viii) and not intended for transient or hotel purposes; must consist solely of one-family units, which is a statutory requirement under 12 U.S.C. 1707(a); and must be in full compliance with all Federal, State, and local laws with respect to zoning, Fair Housing, and accessibility for persons with disabilities, including but not limited to the Fair Housing Act, 42 U.S.C. 3601 et seq., Section 504 of the Rehabilitation Act, 29 U.S.C. 794, and the Americans with Disabilities Act, 42 U.S.C. 12101 et seq., where relevant. Infrastructure includes the project’s streets, storm water management, water and sewage systems, and utilities, along with the project’s common elements and amenities, such as parking lots, community buildings, swimming pools, golf courses, playgrounds, and any similar items, called for in the project or legal phase.

In addition to these general requirements, condominiums must meet further approval requirements as provided by HUD. Some of these requirements are underwriting matters or existing legal requirements such as the nature of the real estate title or leasehold; unit owner control of the Condominium Association; insurance coverage; and statements regarding financial condition, special assessments, property conditions, and pending legal actions. These are the types of matters that HUD routinely considers when determining eligibility for FHA programs.

In addition, the rule would implement some regulatory standards specific to condominiums, but seeks to do so in a way that is flexible and responsive to the market while continuing to involve the public in the rulemaking process. Section 203.43b(d)(6)(vii) would provide for HUD to set a standard for the maximum commercial/nonresidential space within a range from 25 percent to 60 percent of the total floor area. Mixed-use developments are a way to integrate housing, land-use, economic and workforce development, as well as transportation and infrastructure development. However, the agency believes that allowing greater than 50 percent commercial/nonresidential space may have a negative impact on the residential character of the project; therefore, HUD would not expect in the near future to allow greater than 50 percent commercial/nonresidential space. HUD may want to allow less based on the experience it gains with this program. Under 12 U.S.C. 1709(y)(2), either HUD or the DELRAP lender, at the option of the requestor, may grant an exception to the standard regarding the maximum percentage of commercial/
Condominium units that meet the marketability of the project, as determined by the Secretary to be within the range stated in rule, with the approval basis if it is not located in a project in which percentage of units in the project that is percentage of units sold within a range is approved or subject to further phasing or a negative determination for significant elements and those of the master plan, will be specified by HUD through notice. If HUD determines in its determination that the 203(k) loan would be required. HUD has a longstanding policy for 203(k) rehabilitation loans for 1-4 unit structures that are primarily residential. A rehabilitation loan for an individual condominium unit under 203(k) necessarily excludes the building exterior and common elements, which are the responsibility of the Association, so that the 203(k) loan would be for the portion of the structure that is inside the unit including the installation of firewalls in the attic of a unit (proposed § 203.43b(f)(4)).

In accordance with HUD’s longstanding policy for 203(k) rehabilitation loans secured by condominium units, this proposed rule would add a provision stating that the maximum loan amount is 100 percent of the after-improvement value of the unit for any condominium unit. (proposed § 203.43b(f)(3)).
Finally, the proposed rule would address the continued applicability of 24 CFR part 234, which now applies, along with section 234 of the Act (12 U.S.C. 1715y) and other HUD issuances specific to part 234, only in cases where projects have blanket mortgages insured by HUD. This proposed rule adds a new § 234.2, entitled "Savings clause," which clarifies that part 203 and this section apply in all cases except where the project has a blanket mortgage insured under section 234(d) of the Act, in which case section 234 of the Act, 24 CFR part 234, and other HUD issuances (including HUD Handbook 4265.1, Home Mortgage Insurance Condominiums; Chapter 11 of HUD Handbook 4150.1, Valuation Analysis for Home Mortgage Insurance and any Mortgagee Letters that discuss section 234 requirements) apply.

Requests for Public Comment

(1) HUD seeks public comment specifically on the proposed requirement in § 203.43(d)(4) that the project or legal phase be "complete and ready for occupancy, including completion of the infrastructure of the project or legal phase, and not subject to further rehabilitation, construction, phasing, or annexation, except to the extent that approval is sought for legal phasing in compliance with the requirements of paragraph (d)(6)(x) of this section." Given that HUD approval of a fully completed project would not require an environmental review, while continuing the current practice of approving proposed or under construction projects could require environmental review, HUD seeks comments on how this rule would affect industry participation in the program.

(2) HUD seeks public comment specifically on whether there is some other indicia of appropriate experience that could be used rather than, or in addition to, experience in underwriting condominium mortgages and/or condominium approval, or the number of loans originated; for instance, is there another type of experience that could provide an indication of competency in condominium project approval, and how would it provide such indication?

(3) HUD seeks public comment specifically on the ranges this rule proposes to establish, within which HUD may set the specific requirements for percentages of Single-Unit Approvals, commercial space, FHA insured units, and owner-occupied units. HUD seeks comment on whether this range approach is the best approach, and whether the ranges proposed are appropriate. The agency would be interested in any data or evidence that could be provided either that the ranges, as proposed, are appropriate, or that a different set of ranges would be more appropriate or would yield additional benefits.

(4) HUD seeks public comment specifically on the proposed revision of the period of project approval from 2 to 3 years, including whether there are any costs and benefits that would be associated with a shorter or longer timeframe.

III. Findings and Certifications

Paperwork Reduction Act

The information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). In accordance with the Paperwork Reduction Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

The burden of the information collections in this rule is estimated as follows:

<table>
<thead>
<tr>
<th>Information collection</th>
<th>Number of respondents</th>
<th>Frequency of response</th>
<th>Total responses</th>
<th>Hours per response</th>
<th>Total burden hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Package Preparation</td>
<td>15,000</td>
<td>1</td>
<td>15,000</td>
<td>2</td>
<td>30,000</td>
</tr>
<tr>
<td>Package Review</td>
<td>15,000</td>
<td>1</td>
<td>15,000</td>
<td>1</td>
<td>15,000</td>
</tr>
<tr>
<td>Quality Assurance</td>
<td>15,000</td>
<td>2</td>
<td>3,000</td>
<td>1</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>45,000</strong></td>
<td><strong>2.2</strong></td>
<td><strong>33,000</strong></td>
<td><strong>4</strong></td>
<td><strong>48,000</strong></td>
</tr>
</tbody>
</table>

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning this collection of information:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
3. Enhance the quality, utility, and clarity of the information to be collected; and
4. Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this rule. Comments must refer to the proposal by name and docket number (FR-5563) and must be sent to:

HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, Fax: (202) 395-6947; and

Reports Liaison Officer, Office of Public and Indian Housing, Department of Housing and Urban Development, Room, 451 7th Street SW., Washington, DC 20410.

Interested persons may submit comments regarding the information collection requirements electronically through the Federal eRulemaking Portal at http://www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the http://www.regulations.gov Web site can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Regulatory Planning and Review

OMB reviewed this proposed rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). This rule was determined to be a "significant regulatory action," as defined in 3(f) of the order (although not an economically significant regulatory action, as provided under section 3(f)(1)
Entities primarily engaged in lending are divided among five primary groups: Banks, thrifts, mortgage banks, credit unions, and mortgage brokers. A precise description of these individual industries is as follows:

**Commercial Banking (NAICS 522110)**

Entities primarily engaged in accepting demand and other deposits and making commercial, industrial, and consumer loans. Commercial banks and branches of foreign banks are included.

**Savings Institutions (NAICS 522120)**

Entities primarily engaged in accepting time deposits, making mortgage and real estate loans, and investing in high-grade securities. Savings and loan associations and savings banks are included in this industry.

**Credit Unions (NAICS 522130)**

Entities primarily engaged in accepting members' share deposits in cooperatives that are organized to offer consumer loans to their members.

**Real Estate Credit (NAICS 522292)**

Entities primarily engaged in lending funds with real estate as collateral. This includes: Construction lending, farm mortgage lending, Federal Land Banks, home equity credit lending, loan correspondents (i.e., lending funds with real estate as collateral), mortgage banking (i.e., nondepository mortgage lending), and mortgage companies.

**Mortgage and Nonmortgage Loan Brokers (NAICS 522310)**

Entities primarily engaged in arranging loans by bringing borrowers and lenders together on a commission or fee basis.

During the 1980s and 1990s, mortgage lending evolved from the traditional portfolio lender model where single companies (bank and thrift depositaries) performed all steps in the mortgage process—making, closing, funding, servicing, and holding the loan—to a more specialized industry of originators, funding lenders, warehouse lenders, separate secondary market buyers of loans, and servicers. A major driving force behind the unbundling of the mortgage functions, as well as the rise of mortgage brokers, has been the rise and eventual dominance of mortgage securitization, which separated the provision of capital from loan origination and servicing. Brokers

---

originates loans mainly for wholesale lenders.

Studies of the mortgage brokerage industry do not find there to be high fixed costs for firms. There is little evidence of economies of scale in mortgage origination but there is some evidence that brokers are more efficient originators than mid-size and large lenders. Olson (2002) reports that his surveys find no economies of scale in mortgage production—a one-person firm produced as many loans per employee as a larger firm. Olson regards brokers as low-cost, highly-competitive firms, vigorously competing with one another and with little opportunity to earn above-normal profits.3

B. Current State of the Market

In 2014, 7,062 institutions reported data on nearly 10 million home mortgage applications, resulted in 6 million originations. This is down from 8.7 million originations in 2013. There was an historically high share of loans originated outside the federally insured banking system by institutions such as independent mortgage companies and credit unions, not subject to Community Reinvestment Act (Federal Reserve, 2015).4

The share of mortgages originated by non-depository, independent mortgage companies has increased sharply in recent years. Small banks and credit unions have also increased market shares over the past decade. The fraction of originations attributable to large banks and their nonbank subsidiaries diminished. Banks and thrifts accounted for 45 percent of all reported mortgage originations; independent mortgage companies 40 percent, credit unions over 9 percent, affiliates, remainders (Federal Reserve, 2015).

In 2014, 7,062 reporting institutions, 4,118 banks and thrifts, 3,367 were small (assets less than $1 billion), 1,984 credit unions, 139 mortgage companies affiliated with depositories (banks and credit unions), 621 independent mortgage companies. In 2014, small banks and credit unions were much more likely to originate conventional higher-priced loans than large banks and mortgage companies. Small banks and credit unions originated about 28 percent of conventional home-purchase loans, but accounted for 59 percent of higher-priced conventional home-purchase loans (Federal Reserve, 2015).

C. Size Standards

SBA's size standards (2016) define whether a business entity is small and, thus, eligible for Government programs and preferences reserved for "small business" concerns. Size standards have been established for types of economic activity, or industry, generally under the North American Industry Classification System (NAICS). For most industries considered, a "small" business is defined by revenue. Size standards are based on another criterion if revenue is not suitable, either because prices are volatile or there are more appropriate measures.

According to the U.S. Census Bureau, revenue for Finance, Insurance and Real Estate includes commissions and fees from all sources, rents, net investment income, interest, dividends, royalties, and net insurance premiums earned. SBA considers a real estate credit small if its annual revenue is no greater than $38.5 million. A mortgage broker is defined as small if its revenue is no greater than $7.5 million.

For three of the industries considered in this analysis (Commercial Banks, Savings Institutions, and Credit Unions), the SBA definition of small is by the dollar amount of assets ($550 million). Assets include: Cash, interest-earning loans, leases, securities, real estate, letters of credit, loans to other banks, any other financial assets, and intangible assets.

The diversity of size standards makes it difficult to perform a precise analysis of the ubiquity small firms. This difficulty is compounded when sources of business statistics do not report their data by SBA's size standards and that industry definition may not be equivalent. When an exact correspondence is not possible, HUD will, by necessity, use an alternative size standard. For example, asset data is collected by the Federal Deposit Insurance Corporation (FDIC) for Commercial Banks and Savings Institutions. FDIC uses $1 billion as a means to categorize banks and thrifts, which is more inclusive than SBA's definition.

D. Prevalence of Small Firms

Estimating the prevalence of small firms in making FHA-insured condoninium loans requires combining statistics from different sources.

FHA INSURED CONDOMINIUM LOANS BY LENDER TYPE *

<table>
<thead>
<tr>
<th>Type of lender</th>
<th>Firms (% of number)</th>
<th>Forward condo loans (% of number of loans)</th>
<th>All condo loans (% of number of loans)</th>
<th>All condo loans (% of dollar volume)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank (Total) ..........</td>
<td>30</td>
<td>20</td>
<td>19</td>
<td>7</td>
</tr>
<tr>
<td>Small Bank** ..........</td>
<td>13</td>
<td>3</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Large Bank</td>
<td>17</td>
<td>17</td>
<td>16</td>
<td>6</td>
</tr>
<tr>
<td>Mortgage Company</td>
<td>66</td>
<td>79</td>
<td>79</td>
<td>93</td>
</tr>
<tr>
<td>Affiliated</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Independent</td>
<td>65</td>
<td>79</td>
<td>79</td>
<td>93</td>
</tr>
<tr>
<td>Credit Union</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Total****</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

* Source: Single Family Data Warehouse 6/1/14–5/31/16.
** Defined as having assets no greater than $1 Billion.
*** All = forward + HECM.
**** Percentages by lender type are rounded and so may not sum to 100.

The table provides us with some insight concerning the types of firms that are involved in making FHA-condo loans. The predominant originators by any measure are mortgage companies. Independent mortgage companies make


79 percent of the loans and 93 percent of the dollar volume. The largest independent mortgage company, Quicken Loans, accounts for over 5.5 percent of all condo loans. In this table, "banks" are equivalent to commercial banks and savings institutions. Small banks (assets of no greater than $1 billion) represent a small proportion of firms (13 percent) and an even smaller percentage of condo loans (3 percent).

Given the dominance of mortgage companies, an estimate of the small companies originating mortgage loans is essential to a good economic analysis. HUD has data concerning the total FHA-insured loans made by the firms also involved in the condo business. An estimate of the total loans can be arrived at by dividing FHA loans by FHA's market share. Doing so will lead to estimates that are inaccurately high for some and too low for others. On average the estimate will be correct. In the last three years (2013-2015), FHA's share of the dollar value of home purchases varied around 15 percent.

The estimated value of loans can be converted to an estimated revenue by multiplying by an appropriate percentage. Estimates of broker income vary between 1 and 3 percent. We use the lower to arrive for a more expensive count of small business. Of all condo lenders, 31 percent of the firms are small mortgage companies (earning less than $7.5 million). These small mortgage companies make 5 percent of all condo loans and 2 percent of the dollar volume.

We counted a total of only 39 credit unions over a two-year period. Credit Unions are not active in making condo loans. The proportion of loans and dollar value made by credit unions is very close to 0 percent. Thus, accuracy in estimating the small/large percentage is not as important as for other types of lenders. We will assume that all credit unions are small because the average asset amount is significantly below $1 billion (Monthly Credit Union Estimates, May 2016).

Small firms constitute 47 percent of originators of FHA-insured condo loans, 9 percent of all condo loans, and 3 percent of the dollar volume.

### ESTIMATES OF PREVALENCE OF SMALL LOAN ORIGINATORS INVOLVED IN FHA CONDO LENDING

<table>
<thead>
<tr>
<th></th>
<th>Small firms (%)</th>
<th>Number of condo loans (%)</th>
<th>Dollar volume of condo loans (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>31</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Mortgage Companies</td>
<td>13</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Credit Unions</td>
<td>3</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>47</strong></td>
<td><strong>9</strong></td>
<td><strong>3</strong></td>
</tr>
</tbody>
</table>

### E. Economic Impact

Approximately half of the firms engaged in making FHA-insured condominium loans are estimated to be small. This share of small firms could change depending upon the regulatory impact of the rule and whether that impact is disproportionate. Although small business constitutes 47 percent of all firms, they originate only 9 percent of all loans, making it more difficult to pass on any costs of origination to borrowers. Reducing (raising) fixed costs benefits (harms) small firms disproportionately more than large ones.

One aspect of the rule that could have a negative and disproportionate impact on small firms are any requirements to participate in the DELRAP program. While many of the requirements will be met with little difficulty by already-approved lenders, requirements that are related to the level of business activity would place a relatively higher burden on small firms. To be qualified for Direct Endorsement authority, a mortgagee must satisfy the following characteristics: Possess at least one year experience in condo loans; have made at least 10 FHA approved condo loans; possess a quality control plan; and participating staff is limited to those with prior experience. All of these requirements would be easier to meet by larger firms with greater capacity. Nonetheless, small firms that have at least occasional experience should be able to satisfy the requirements without undue burden.

Other elements of the rule lift regulatory burdens. First, allowing Single-Unit Approval enables small lenders business opportunities without the cost of seeking approval for an entire condominium project. Second, by providing that only completed projects may be approved, this rule eliminates the need for HUD to require an environmental review from lenders as a condition of approval. This change will benefit small firms that are less likely to retain specialists. Although some components of the rule raise the cost of compliance for small firms, other elements will expand their opportunities and allow them to spread the compliance costs over a greater number of loans. Also, participation in condominium insurance, like HUD's other mortgage insurance programs, is purely voluntary.

Therefore, the undersigned certifies that this rule will not have a significant impact on a substantial number of small entities.

As noted in the accompanying Regulatory Impact Analysis, the average cost of a project DELRAP approval would be $1,250. Extending the approval period to 3 years reduces this cost by approximately one-third for all lenders.

Economic Impact

Executive Order 13132, Federalism

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Catalog of Federal Domestic Assistance Number

The Catalog of Federal Domestic Assistance number for 24 CFR parts 203 and 234 is 14.117.

List of Subjects

24 CFR Part 203

Hawaiian Natives, Home improvement, Indians-lands, Loan
programs-housing and community development, Mortgage insurance, Reporting and recordkeeping requirements, Solar energy.

24 CFR Part 234

Condominiums, Mortgage insurance, Reporting and recordkeeping requirements.

For the reasons stated in the foregoing preamble, HUD proposes to amend 24 CFR parts 203 and 234 as follows:

PART 203—SINGLE FAMILY MORTGAGE INSURANCE

1. The authority citation for part 203 is revised to read as follows:


Subpart A—Eligibility Requirements and Underwriting Procedures

2. Add § 203.8 to read as follows:

§ 203.8 Approval of mortgagees for Direct Endorsement Lender Review and Approval Process (DELRAP).

(a) General. Each mortgagee that chooses to participate in the review and approval of Condominium Projects, as set forth in § 203.43b, must be granted authority to participate in the Direct Endorsement Lender Review and Approval Process (DELRAP).

(b) DELRAP Authority—(1) Eligibility. To be granted DELRAP authority, as described in § 203.43b, a mortgagee must be unconditionally approved for the Direct Endorsement program as provided in § 203.3 and meet the following requirements:

(i) Have staff with at least one year of experience in underwriting mortgages on condominiums and/or condominium project approval;

(ii) Have originated not less than 10 condominium loans in projects approved by the Commissioner;

(iii) Have an acceptable quality control plan that includes specific provisions related to DELRAP; and

(iv) Ensure that only staff members meeting the above experience requirements participate in the approval of a Condominium Project using DELRAP authority.

(2) Conditional DELRAP Authority. Mortgagees will be granted Conditional DELRAP authority upon provision of notice to the Commissioner of the intent to use DELRAP. Mortgagees with Conditional DELRAP authority must submit all recommended Condominium Project approvals, denials and recertifications to FHA for review. If FHA agrees with the mortgagee’s recommendation, it will advise the mortgagee that it may proceed with the recommended decision on the Condominium Project.

(3) Unconditional DELRAP Authority. Mortgagees will be granted unconditional DELRAP authority after completing at least five (5) DELRAP reviews to the satisfaction of the Commissioner and may then exercise DELRAP authority to approve projects in accordance with requirements of the Commissioner.

(c) Reviews. HUD will monitor a mortgagee’s performance in DELRAP on an ongoing basis.

(1) If the review shows that there are no material deficiencies, subsequent project approvals, denials or recertifications may be selected for post-action review based on a percentage as determined by the Commissioner.

(2) If the review shows that there are deficiencies in the mortgagee’s DELRAP performance, the mortgagee may be returned to Conditional DELRAP status.

(3) If additional reviews continue to show deficiencies in the mortgagee’s DELRAP performance, the mortgagee’s authority to participate in DELRAP may be terminated or other action taken against the mortgagee or responsible staff reviewer.

(d) Termination of DELRAP Authority.

(1) HUD may immediately terminate the mortgagee’s authority to participate in DELRAP or take any action listed in 24 CFR 203.3(d) if the mortgagee:

(i) Violates any of the requirements and procedures established by the Secretary for mortgagees approved to participate in DELRAP, the Direct Endorsement program, or the Title II Single Family mortgage insurance program; or

(ii) If HUD determines that other good cause exists.

(2) Such termination will be effective upon receipt of HUD’s notice advising of the termination.

(3) Notwithstanding any provisions of this section, the Commissioner reserves the right to take administrative action, including revocation of DELRAP authority, against any mortgagee and staff reviewer because of unacceptable performance. Any termination instituted under this section is distinct from withdrawal of mortgagee approval by the Mortgagee Review Board under 24 CFR part 25.

(e) Reinstatement. A mortgagee whose DELRAP authority is terminated under this section may request reinstatement if the mortgagee’s DELRAP authority has been terminated for at least 6 months. In addition to addressing the eligibility criteria specified in paragraph (b)(1) of this section, the application for reinstatement must be accompanied by a corrective action plan addressing the issues that led to the termination of the mortgagee’s DELRAP authority, along with evidence that the mortgagee has implemented the corrective action plan. The Commissioner may grant Conditional DELRAP authority if the mortgagee’s application is complete and the Commissioner determines that the underlying causes for the termination have been satisfactorily remedied. The mortgagee will be required to complete successfully at least five (5) test cases in accordance with paragraph (b)(2) in order to receive unconditional DELRAP authority as provided in paragraph (b)(3) above.

3. Revise § 203.17(a)(1) to read as follows:

§ 203.17 Mortgage provisions.

(a) Mortgage form. (1) The term “mortgage” as used in this part, except § 203.43c, shall have the meaning given in Section 201 of the National Housing Act, as amended (12 U.S.C. 1707).

4. Add 203.43b to read as follows:

§ 203.43b Eligibility of mortgages on single-family condominium units.

(a) Definitions. As used in this part:

(1) Condominium Association (Association) means the organization, regardless of its formal legal name that consists of homeowners within a condominium project for the purpose of managing the financial and common-area assets.

(2) Condominium Project shall mean a multifamily project, including manufactured housing units, and in which one-family dwelling units are attached, semi-detached, or detached, or are manufactured housing units, and in which owners hold an undivided interest in the common areas and facilities that serve the project.

(3) Condominium Unit shall mean a project in which one-family dwelling units are attached, semi-detached, or detached, or are manufactured housing units, and in which owners hold an undivided interest in the common areas and facilities that serve the project.

(4) Infrastructure means the condemnasion project’s streets, storm water management, water and sewage systems, and utilities, along with the project’s common elements and amenities, such as parking lots, community buildings, swimming pools, golf courses, playgrounds, and any similar items, called for in the project or legal phase.

(5) Rental for Transient or Hotel Purposes shall have the meaning given...
in section 513(e) of the National Housing Act (12 U.S.C. 1731b(e)).

(6) Single-Unit Approval means approval of one unit in an unapproved condominium project under paragraph (h) of this section.

(7) Site Condominium means a single family detached dwelling (which does not have a shared garage or any other attached building, including such improvements as archways, or breezeways), which is encumbered by a declaration of condominium covenants or condominium form of ownership, and which consists of the entire structure as well as the site and air space and is not considered to be a common area or limited common area.

(b) Eligibility. A mortgage secured by a Condominium Unit shall be eligible for insurance under section 203 of the National Housing Act if it meets the requirements of this subpart, except as modified by this section.

(c) Approval required. To be eligible for insurance under this section, a Condominium Unit must be located in a Condominium Project approved by HUD or a DELRAP mortgagee approved under § 203.8, or meet the additional requirements for approval as a Site Condominium or Single-Unit Approval.

(d) Condominium Project Approval: Eligibility Requirements. To be eligible for Condominium Project approval, the Condominium Project must:

(1) Be primarily residential in nature and not be intended for rental for Transient or Hotel Purposes;

(2) Consist of units that are solely one-family units;

(3) Be in full compliance with all applicable Federal, State, and local laws with respect to zoning, Fair Housing, and accessibility for persons with disabilities, including but not limited to the Fair Housing Act, 42 U.S.C. 3601 et seq., Section 504 of the Rehabilitation Act, 29 U.S.C. 794, and the Americans with Disabilities Act, 42 U.S.C. 12101 et seq., where relevant;

(4) Be complete and ready for occupancy, including completion of all the infrastructure of the project or legal phase, and not subject to further rehabilitation, construction, phasing, or annexation, except to the extent that approval is sought for legal phasing in compliance with the requirements of paragraph (d)(6)(x) of this section;

(5) Be reviewed and approved by the local jurisdiction with respect to the condominium plat or similar development plan and any phases; if applicable, the approved plat or development plan must have been recorded in the land records of the jurisdiction; and

(6) Meet such further approval requirements as provided by the Commissioner through notices with respect to:

(i) Nature of title to reality or leasehold interests;

(ii) Control over, and organization of, the Condominium Association;

(iii) Minimum insurance coverage for the Condominium Project;

(iv) Planned or actual special assessments;

(v) Financial condition of the Condominium Project;

(vi) Existence of any pending legal action, or physical property condition;

(vii) Commercial/non-residential space, which must be within a range between 25 and 60 percent of the total floor area (which range may be changed following the procedures in paragraph (d)(6) of this section), with the specific maximum and minimum percentages within that range to be established by HUD through notice, provided that such commercial/non-residential space does not negatively impact the residential use of the project or create adverse conditions to the occupants of individual condominium units.

(viii) Acceptable maximum percentages of units with FHA-insured mortgages, which must be within a range between 25 and 75 percent of the total number of units in the project (which range may be changed following the procedures in paragraph (d)(6) of this section), with the specific maximum percentage of units with FHA-insured mortgages within that range to be established by HUD through notice.

(ix) Acceptable minimum levels of owner occupancy, including units under a bona fide contract to purchase by a purchaser who occupies or will occupy the unit as their principal residence as well as a purchaser who occupies or intends to occupy the unit as a secondary residence, as defined in § 203.18(f)(2), within a range between 25 and 75 percent of the total number of units in the project (which may be changed following the procedures in paragraph (d)(6) of this section), with a specific minimum percentage to be established by HUD through notice.

(x) Phasing, provided that only legal phasing is permitted and individual phases must contain sufficient numbers of units to be separately sustainable as required by HUD, so that the insurance fund is not put at undue risk. In determining whether to accept legal phasing, HUD will assess the potential risk to the insurance fund and other factors that HUD may publish in notices. Phases must meet HUD's requirements for approval in paragraph (d) of this section and must at a minimum be:

(A) In a vertical building, contiguous, with all units built out and having a certificate of occupancy; or

(B) In a detached or semi-detached development, consisting of groups of adjoining or contiguous homes (which may include, at HUD's discretion, easements for utilities and roads serving the homes), where all homes in a phase are built out and have a certificate of occupancy.

(xi) Reserve requirements, provided the reserve account is funded with at least 10 percent of the monthly unit assessments, unless a lower amount is deemed acceptable by HUD based on a reserve study completed not more than 24 months before a request for a lower amount is received.

(xii) Such other matters that may affect the viability or marketability of the project or its units.

(e) The Secretary will publish any generally applicable change in the upper and lower limits of the ranges of percentages in paragraphs (d)(6)(vii) through (ix) of this section in a notice published for 30 days of public comment. After considering the comments, the Department will publish a final notice announcing the new overall upper and lower limits of the range of percentages being implemented, and the date on which the new standard becomes effective.

(f) The Secretary may grant an exception to any specifically prescribed requirements within paragraph (d)(6) of this section on a case-by-case basis in HUD's discretion, provided that:

(1) In the case of an exception to the approval requirements for the commercial/nonresidential space percentage that HUD establishes under paragraph (d)(6)(vii) of this section, any request for such an exception and the determination of the disposition of such request may be made, at the option of the requester, under the direct endorsement lender review and approval process or under the HUD review and approval process through the applicable field office of the Department.

(2) In determining whether to allow such an exception, factors relating to the economy for the locality in which the project is located or specific to the project, including the total number of family units in the project, shall be considered. A DELRAP lender, in determining whether to grant a requested exception, shall follow any procedures that HUD may establish.

(g) Application for Condominium Project approval and Renewal of Approval. (1) In order to become
approved, an application for Condominium Project approval, in accordance with the requirements of the Commissioner, must be submitted to either HUD or a DELRAP mortgagee, if consistent with the mortgagee’s DELRAP approval.

(2) The application will be reviewed and if all eligibility criteria have been met, the Condominium Project will be approved and placed on the list of HUD-approved Condominium Projects.

(3) Unless otherwise specified in writing by HUD, Condominium Projects are approved for a period of three (3) years from the date of placement on the list of approved condominiums. HUD may rescind a Condominium Project’s approval at any time if the project fails to comply with any requirement for approval.

(4) Eligible parties may request renewal of the approval of an approved Condominium Project by submitting a request for recertification no earlier than 6 months prior to expiration of the approval or no later than 6 months after expiration of the approval. HUD shall specify the format for the recertification request, which shall allow the request to be supported by updating previously submitted information, rather than resubmission of all information. However, if the request for recertification is not submitted within 6 months after the expiration of the Condominium Project’s approval, a complete, new approval application is required.

(h) Single-Unit Approval. (1) Limit on Single-Unit Approvals. HUD will not insure mortgages in an unapproved project if the percentage of such mortgages exceeds an amount determined by the Commissioner to be necessary for the protection of the insurance fund, which percentage will be specified by the Commissioner by notice.

(2) Single-Unit Approvals. Mortgagees must ensure that the Condominium Unit is located in a Condominium Project that either meets the eligibility requirements for approval as set forth in paragraph (d)(4) of this section as modified by this paragraph, except that HUD may provide that Single-Unit Approvals may be approved by meeting a subset of these standards, or less stringent standards, as stated by notice. In addition, a unit may be eligible for Single-Unit Approval if it:

(i) Is not in a Condominium Project that is on the list of FHA-approved Condominium Projects, or in a project that has been subject to adverse determination for significant issues that affect the viability of the project;

(ii) Is a project that is complete under paragraph (d)(4) of this section;

(iii) Is not a manufactured housing condominium project or 2-4 unit project;

(iv) Is not a manufactured home and is in a project that has at least 5 dwelling units; and

(v) Is in a project in which the amount of Single-Unit Approvals is limited to a percentage of the total number of units in the project that is within a range of 0 to 20 percent, with the exact percentage within that range to be determined by HUD through notice.

(3) HUD will publish any generally applicable change in the overall upper and lower limits of the range stated in paragraph (h)(2)(iv) of this section by notice published for 30 days of public comment. After considering the comments, HUD will publish a final notice announcing the new upper and lower limit of the range of percentages being implemented, and the date on which the new standard becomes effective.

(i) Site Condominium. Site condominiums are as defined in §203.43b. Site Condominiums must meet all of the requirements of paragraph (d)(1) of this section for approval, except that:

(1) Insurance and maintenance costs must be the sole responsibility of the unit owner; and

(2) Any common assessments collected must be restricted to use solely for amenities outside of the footprint of the individual site.

5. Amend §203.50 to revise paragraphs (a)(1) and (f) to read as follows:

§203.50 Eligibility of rehabilitation loans. * * * * *

(a) * * * *

(1) The term rehabilitation loan means a loan, advance of credit, or purchase of an obligation representing a loan or advancement of credit, made for the purpose of financing:

(i) The rehabilitation of an existing one-to-four unit structure which will be used primarily for residential purposes;

(ii) The rehabilitation of such a structure and refinancing of the outstanding indebtedness on such structure and the real property on which the structure is located;

(iii) The rehabilitation of such a structure and the purchase of the structure and the real property on which it is located; or

(iv) The rehabilitation of the interior space or the installation of firewalls in the attic of a condominium unit, as defined in §203.43b, excluding any exteriors or areas that are the responsibility of the Association; and

(f) The loan may not exceed an amount which, when added to any outstanding indebtedness of the borrower that is secured by the property, creates an outstanding indebtedness in excess of the lesser of:

(1)(i) The limits prescribed in §203.18(a)(1) and (3) in the case of a dwelling to be occupied as a principal residence, as defined in §203.18(f)(1));

(ii) The limits prescribed in §203.18(a)(1) and (4) in the case of a dwelling to be occupied as a secondary residence, as defined in §203.18(f)(2));

(iii) Eighty-five (85) percent of the limits prescribed in §203.18(c), or such higher limit, not to exceed the limits set forth in §203.18(a)(1) and (3), as the Secretary may prescribe (in the case of an eligible non-occupant mortgage as defined in §203.18(f)(3));

(iv) The limits prescribed in §203.18(a), based upon the sum of the estimated cost of rehabilitation and the Commissioner’s estimate of the value of the property before rehabilitation;

(2) The limits prescribed in the authorities listed in this paragraph (f), based upon 110 percent of the Commissioner’s estimate of the value of the property after rehabilitation; or

(3) For any Condominium Unit that is not a detached dwelling, attached townhouse dwelling, manufactured home (as defined in 24 CFR 3280.2), or site condominium (as defined in §203.43b), 100 percent of the after-improvement value of the Condominium Unit.

* * * * *

PART 234—CONDOMINIUM OWNERSHIP MORTGAGE INSURANCE

6. The authority citation for part 234 continues to read as follows:


Subpart A—Eligibility Requirements—Individually Owned Units

7. Add §234.2 to read as follows:

§234.2 Savings clause.

Effective [date that is 30 days after the date of publication of the final rule], HUD’s regulations at §203.43b of this chapter govern approval of real estate consisting of a one-family unit in a multifamily project, and an undivided interest in the common areas and facilities which serve the project, except where the project has a blanket mortgage insured under section 234(d) of the National Housing Act, 12 U.S.C.
Background and Explanation of Provisions

This document contains amendments to the Income Tax Regulations (26 CFR part 1) relating to RICs. Section 851 of the Internal Revenue Code (Code) sets forth requirements for qualifying as a RIC.

Section 851(a) provides that any domestic corporation that (1) at all times during the taxable year is registered under the Investment Company Act of 1940, Public Law 76–768, 54 Stat. 789 (codified as amended at 15 U.S.C. 80a–1—80a–64 (2016)) (the 1940 Act), as a management company or unit investment trust or has in effect an election under the 1940 Act to be treated as a business development company; or (2) is a common trust fund or other similar fund excluded by section 3(c)(3) of the 1940 Act from the definition of “investment company” and is not included in the definition of “common trust fund” by section 584(a).

To be treated as a RIC for a taxable year, a corporation must satisfy the income test set forth in section 851(b). The income test under section 851(b)(2) requires that at least 90 percent of the corporation’s gross income for the taxable year be derived from:

(A) dividends, interest, payments with respect to securities loans (as defined in section 512(a)(3)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act), foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies, and
(B) net income derived from an interest in a qualified publicly traded partnership (as defined in section 851(b)).

Section 851(b)(3) provides that to be treated as a RIC a corporation also must satisfy the following asset diversification requirements at the close of each quarter of the corporation’s taxable year:

(A) at least 50 percent of the value of its total assets is represented by—
(i) cash and cash items (including receivables), Government securities and securities of other RICs, and
(ii) other securities for purposes of this calculation limited, except and to the extent provided in [section 851(e)], in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the taxpayer and to not more than 10 percent of the outstanding voting securities of such issuer, and
(B) not more than 25 percent of the value of its total assets is invested in—
(i) the securities (other than Government securities or the securities of other RICs) of any one issuer, and
(ii) the securities (other than the securities of other RICs) of two or more issuers which the taxpayer controls and which are determined, under regulations prescribed by the Secretary, to be engaged in the same or similar trades or businesses or related trades or businesses, or

These proposed regulations relate to the RIC income test and asset diversification requirements. Section A of this preamble concerns the meaning of security. Section B of this preamble addresses inclusions under sections 951(a)(1)(A)(i) and 1293(a). These proposed regulations also revise § 1.851–2(b)(1) of the existing final regulations to merely incorporate changes to section 851(b)(2) since the existing final regulations were published in the Federal Register on November 26, 1960, in TD 6500 (25 FR 11910).

A. Defining Securities

The income test and asset diversification requirements both use the term “securities.” For purposes of the income test, a security is defined by reference to section 2(a)(36) of the 1940 Act, while section 851(c) provides rules and definitions that apply for purposes of the asset diversification requirements of section 851(b)(3) but does not specifically define “security.” Section 851(c)(8), however, provides that the terms used in section 851(b)(3) and (c) have the same meaning as when used in the 1940 Act. An asset is therefore a security for purposes of the income test and the asset diversification requirements if it is a security under the 1940 Act.

The Treasury Department and the IRS have in the past addressed whether certain instruments or positions are securities for purposes of section 851. In particular, Rev. Rul. 2006–1 (2006–1 CB 261) concludes that a derivative contract with respect to a commodity index is not a security for purposes of section 851(b)(2). The ruling also holds that income from such a contract is not qualifying other income for purposes of section 851(b)(2) because that income is not derived with respect to the RIC’s business of investing in stocks, securities, or currencies. Rev. Rul. 2006–1 was modified and clarified by Rev. Rul. 2006–31 (2006–1 CB 1133), which states that Rev. Rul. 2006–1 was not intended to preclude a conclusion that income from certain instruments (such as certain structured notes) that create commodity exposure for the holder is qualifying income under section 851(b)(2).

After the issuance of Rev. Rul. 2006–31, the IRS received a number of private