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CHAPTER 1: INTRODUCTION

SECTION 1: INTRODUCTION TO THE ASSET MANAGEMENT HANDBOOK

1.1 ABOUT THIS HANDBOOK

This handbook provides Multi-Family Housing staff with guidance about the Agency's procedures for overseeing borrowers' performance in meeting their responsibilities under the program. Its goal is to help Loan Servicers in Field Offices provide consistent, effective oversight of projects financed by the Agency to ensure that they are operated in accordance with applicable regulatory and administrative requirements. This role is defined as asset management.

This handbook presents the Agency's asset management procedures for:

- Section 515 Multi-Family Housing projects:
  - ◊ Rural rental housing (including congregate housing and group homes); and
  - ◊ Rural cooperative housing.
- Section 514/516 Farm Labor Housing projects:
  - ◊ Off-farm labor housing; and
  - ◊ On-farm labor housing.

The guidance provided by this handbook is intended to be consistent with all applicable laws, Executive Orders, and Departmental regulations, including other Agency regulations. Nothing contained in this handbook should be construed to supersede, rescind, or otherwise amend such laws, Executive Orders, and regulations.

1.2 COMPANION MULTI-FAMILY HOUSING HANDBOOKS

This handbook is the second in a series of three handbooks that describe the requirements and procedures for the Multi-Family Housing direct loan and grant programs. The two companion handbooks are:

- **HB-1-3560: Loan Origination.** This handbook covers the requirements and procedures for processing loan and grant applications for Multi-Family Housing projects, selecting projects for Agency funding, and closing the loans and grants for these projects.
- **HB-3-3560: Project Servicing.** This handbook addresses the requirements and procedures for servicing loan accounts, allowable servicing actions borrowers can request, project preservation, prepayment, and Agency actions in the event of compliance violations or project default.

1.3 USING THIS HANDBOOK

The handbook is organized to allow the reader to look up information on specific topics easily. Several graphic tools and conventions have been used to make information easier to find and understand.

A. Citations and Text Boxes

- **Regulatory citations.** The regulation for Multi-Family Housing programs is provided in 7 CFR Part 3560. The text of that regulation is included in **Appendix 1**. To help readers locate the regulatory authority for procedures described here, references to this regulation in paragraph headings appear in italicized brackets, for example: *[7 CFR 3560.51]*. Other regulations or RD Instructions are simply referenced.

- **Form references.** Agency forms and Agency guide, form, and system letters are shown in *italics.* All forms referenced in this handbook can be found in **Appendix 3** and all letters can be found in **Appendix 4**.

- **Examples and exhibits.** Text boxes labeled as examples provide a specific illustration of a concept described in the text. Exhibits illustrate key points and are numbered in sequence, using the chapter number and a sequence number; for example, Exhibit 3-1 is the first exhibit in Chapter 3.

B. Attachments and Appendices

- **Attachments.** Attachments at the end of each chapter contain technical information that is specific to the topics covered in the chapter. Attachments are referenced in sequence using the chapter number and a sequence letter; for example, **Attachment 4-A** is the first attachment in Chapter 4.

- **Appendices.** Appendices at the end of the handbook include forms and other reference materials that relate to multiple chapters.

C. Terminology

Because terminology may vary from state to state and may change over time, this handbook uses certain standard terminology to provide consistency.

- **Agency.** The term “Agency” is used throughout this handbook to refer to the Rural Housing Service (RHS) within the U.S. Department of Agriculture (USDA) that is responsible for the administration of the Multi-Family Housing programs.

- **Approval Official.** This term is used whenever someone other than the Loan Servicer must approve an action.

- **Borrower.** The term "borrower" refers to one or more individuals who are receiving Agency assistance through a Multi-Family Housing program in the form of a loan or a grant.

- **Field Office.** Because the number of offices and the nature of the work conducted in each office may vary from state to state, the term "Field Office" is used throughout this handbook to refer to the office that is originating or servicing the loan.

- **Loan Servicers.** This term refers to Agency Field Office staff with responsibility for ensuring that multi-family housing borrowers comply with program requirements and for servicing loan accounts.

- **Management Agent.** A "management agent" is an entity that contracts with the borrower to perform the management functions necessary to effectively operate a multi-family housing project.

- **State Director.** This term is used to refer to the Director of the State Office or the Agency staff person to whom the State Director has delegated decision-making authority for a specific aspect of the program. Unless otherwise specified, each State Director may determine which actions may be approved at the Field Office and which must be approved at the State Office.

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SECTION 2: OVERVIEW OF THE AGENCY'S MULTI-FAMILY HOUSING PROGRAMS

1.4 GOALS OF THE RHS MULTI-FAMILY HOUSING PROGRAMS

The purpose of the Multi-Family Housing programs is to provide adequate, affordable, decent, safe, and sanitary rental units for very low-, low-, and moderate-income households in rural areas. In providing this service, the Agency strives to meet several goals.

- **Customer service.** The Agency is committed to providing customer-friendly, streamlined service. The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders.

- **Partnerships.** The Agency's ability to serve eligible households is enhanced by working with its partners, such as borrowers, property management agents, tenants, other lenders, nonprofit organizations, and state and local agencies.

- **Effective use of resources.** As publicly funded initiatives, the Agency's Multi-Family Housing programs must use tax dollars efficiently. The Agency aims to minimize administrative costs, underwrite loans responsibly, and leverage funding with private sources of credit to the extent possible.

1.5 SECTION 515 PROGRAM—OVERVIEW

The Section 515 direct loan program *[7 CFR Part 3560]* provides financing to support the development of rental units in rural areas that need housing affordable for very low-, low-, and moderate-income households, and where this housing is unlikely to be provided through other means.

Section 515 loans can be used to build, acquire and rehabilitate, or improve dwellings in rural areas. The term for loans is tied to the expected useful life of the property, and the standard term for an initial Section 515 loan is 30 years with a 50-year amortization period. However, the term for subsequent loans and loans for special types of properties, such as manufactured housing, may be made for a shorter term based on the project's expected useful life.

Each loan is made at a note rate established by the Agency as prescribed in RD Instruction 440.1. Borrowers approved for initial and/or subsequent loans receive interest credit that reduces the effective interest rate for the Agency's financing, thereby lowering the property's rents. In return for this below-market rate financing, the borrower agrees to lease the project's rental units to income-eligible households at rents approved by the Agency.

1.6 SECTION 514/516 PROGRAMS—OVERVIEW

Section 514/516 direct loan and grant programs provide funds to support the development of adequate, affordable housing for farmworkers that is unlikely to be provided through other means.

A. Section 514 Loans and Section 516 Grants for Off-Farm Housing

Section 514 loans and Section 516 grants can be used for the same purposes as Section 515 loans to finance rental housing for farmworkers. Unlike Section 515 projects, Off-Farm Labor Housing projects may be built outside rural areas, as long as the project addresses a need for affordable housing for farmworkers. These projects are eligible for financing at terms comparable to Section 515 loans, a grant to cover a significant share of the development cost, or a loan/grant combination finance package. Tenants not only must be income-eligible, but also receive priority based on the proportion of their income received from farm work.

B. Section 514 Loans for On-Farm Housing

Section 514 loans can also be used to finance the development of adequate housing for farmworkers involved in a specific farm operation—On-Farm Labor Housing projects. These projects are treated as part of the farming operation, and the occupants do not pay shelter cost (rent and utilities) unless the shelter cost is approved by the Agency.

Labor housing borrowers who are providing shelter for domestic farm housing that is restricted for use by eligible residents supporting the borrower's farming operation may choose to provide that housing to residents without imposing charges for rent or utilities or may choose to impose charges for rent, utilities, or rent and utilities subject to Agency approval.

SECTION 3: GENERAL PROGRAM REQUIREMENTS

1.7 CIVIL RIGHTS *[7 CFR 3560.2]*

The Agency will administer its programs fairly and in accordance with both the letter and the spirit of all equal opportunity and fair housing legislation and applicable Executive Orders. The civil rights compliance requirements for the Agency are contained in RD Instruction 1901-E. Exhibit 1-1 lists the applicable Federal laws and Executive Orders and highlights key aspects of these requirements.

Exhibit 1-1

Major Civil Rights Laws Affecting the Multi-Family Housing Loan and Grant Programs

- **Equal Credit Opportunity Act (ECOA).** Prohibits discrimination in the extension of credit on the basis of race, color, religion, national origin, sex, marital status, age, income from public assistance, and exercise of rights under the Consumer Credit Protection Act.
- **Title VI of the Civil Rights Act of 1964.** Prohibits discrimination in a Federally-assisted program on the basis of race, color, and national origin.
- **Title VIII of the Civil Rights Act of 1968** (also known as the Fair Housing Act of 1988, as amended). Prohibits discrimination in the sale, rental, or financing of housing on the basis of race, color, religion, sex, national origin, familial status, or disability.
- **Section 504 of the Rehabilitation Act of 1973.** Prohibits discrimination in a Federally-assisted program on the basis of disability.
- **Age Discrimination Act of 1975.** Prohibits discrimination in a Federally-assisted program on the basis of age.
- **Title IX of the Education Amendments of 1972.** Prohibits discrimination on the basis of sex in education programs and activities receiving Federal financial assistance from Rural Development.
- **Executive Order 11063 as Amended by Executive Order 12259.** Prohibits discrimination in housing or residential property financing to any Federally-assisted activity against individuals on the basis of race, color, religion, sex, or national origin.
- **Executive Order 11246.** Prohibits discrimination in employment by construction contractors (and subcontractors) receiving Federally-assisted construction contracts in excess of $10,000. Provides for equal employment opportunity without regard to race, color, religion, sex, and national origin.
- **Executive Order 12898**. Requires each federal agency to make achieving environmental justice a part of its mission by identifying and addressing disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority and low-income populations.

A. Nondiscrimination

The various civil rights laws prohibit the denial of loans, grants, services, and benefits provided under the Section 515 and 514/516 programs to any person on the basis of race, color, national origin, sex, religion, marital status, familial status, age, physical or mental disability or source of income, or because the applicant has, in good faith, exercised any right under the Consumer Credit Protection Act (15 U.S.C. 1601). Discrimination in employment practices is also prohibited. These same requirements also apply to program participants. Agency oversight of borrower compliance with civil rights laws is covered further in Chapters 3, 6, and 9. Civil rights complaints filed by tenants are handled by the Agency in accordance with RD Instruction 2000-GGG.

Effective management and consistent procedures are good business practices that help ensure that all applicants are treated fairly. Poor program implementation, whether or not discrimination is intended, has possible civil rights consequences.

Key Civil Rights Issues for Asset Management

- Access
- Consistency and fairness of treatment
- Disparate impacts—intended or unintended
- Record keeping

B. Reasonable Accommodations for Persons with Disabilities

In addition to avoiding discrimination, the Agency and loan and grant recipients must make reasonable accommodations to permit persons with disabilities to apply for and benefit from Agency programs. Reasonable accommodations may include providing modifications to the dwellings and facilities so that they are physically accessible. Reasonable accommodations may also include effective communication and outreach tools so that all applicants can obtain program information (e.g., a Telecommunications Device for the Deaf [TDD]).

C. Limited English Proficiency *[7 CFR 3560.2]*

Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from Federally-assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

D. Civil Rights Impact Analysis

Agency employees will conduct civil rights impact analyses in accordance with RD Instruction 2006-P, to determine whether proposed policy actions, if approved and implemented, will negatively and disproportionately affect employees, program

beneficiaries, or applicants for employment or program benefits due to race, national origin, or other protected basis.

1.8 REVIEWS AND APPEALS *[7 CFR 3560.9]*

Decisions that are not made in favor of a program participant (applicant or borrower) are known as adverse decisions. Adverse decisions must be based upon regulations that are published in the Code of Federal Regulations (CFR). For the direct Multi-Family Housing programs, any adverse decisions must be based upon 7 CFR Part 3560 and not the administrative guidance contained in this handbook. Adverse decisions include: (1) administrative actions taken by Agency officials; and (2) the Agency's failure to take required actions within time frames specified in statutes or regulations or within a reasonable time if no deadline is specified. **Appendix 2** contains 7 CFR Part 11, which is the regulation of the National Appeals Division (NAD) and provides procedures that both Agency officials and program participants must follow when an appeal is made. *Handbook Letter 101 (3560), Standardized Adverse Decision Letter*, will be used for all adverse decisions unless another format is prescribed in this handbook.

A. Informing Program Participants of Their Rights

Whenever an Agency official makes a decision that will adversely affect a program participant, the official must inform the participant in writing that an informal review with the person who made the decision may be requested. If the decision is appealable, the participant will also be informed of their rights to seek mediation or Alternative Dispute Resolution (ADR) and to request a hearing with NAD; **Attachment 1-B** is used for this purpose. If the decision cannot be appealed, participants will be informed of their rights to have NAD review the accuracy of the Agency's finding that the decision cannot be appealed; **Attachment 1-C** is used for this purpose. Mediation or ADR rights are not provided on decisions that cannot be appealed.

Letters notifying participants of adverse decisions must contain the required information regarding an informal meeting, mediation or ADR, rights to NAD, and civil rights. RD Instruction 2000-GGG includes only the specific civil rights language that must be contained in any adverse decision letter. **Attachments 1-B** through **1-I** contain, as necessary, the civil rights language and include information on requesting an informal review, mediation or ADR, and rights to a NAD appeal. The attachments are all titled to assist Field Staff in selecting the correct Attachment for the decision being made. The Attachments do not need to be used when an RD Form, Handbook Letter, or other document already includes the appropriate participant rights.

B. Adverse Decisions That Cannot Be Appealed

Certain decisions made by the Agency cannot be appealed. In these cases, the participant is still provided the opportunity for an informal review, however, appeal rights to an NAD and rights to mediation or ADR are not offered. Participants will be informed through the use of **Attachment 1-C** that they may request an informal review and write to NAD for a review of the accuracy of the Agency's determination that the case cannot be appealed. Decisions that cannot be appealed include:

- Decisions made by parties outside the Agency, even when these decisions are used as a basis for Agency decisions (such as when an applicant disagrees with a private lender's decision not to provide credit for a leveraged loan);
- Denials of credit due to lack of funds; and
- Rural area designations.

When one or more of the reasons for an adverse decision are reasons that cannot be appealed, the adverse decision cannot be appealed. In these cases, the letter containing the adverse decision will include only the items that cannot be appealed as the reason why the decision cannot be appealed. If other reasons also exist for the adverse decision, they will be listed separately in the decision letter as other reasons the assistance could not be granted.

C. Informal Review

Participants who want to request an informal review with the person who made the decision must do so within 15 days of the date of the Agency's letter notifying the participant of the adverse decision. The participant must make a request for an informal review in writing, and the request will be retained in the participant's case file. The informal review can be conducted, at the discretion of the Agency by telephone or through a face-to-face meeting. The informal review can also be conducted by a representative of the person who made the decision. The purpose of the informal review is to further explain the Agency's reasons for the adverse decision, listen to why the participant feels the decision may be incorrect, and obtain any further information from the participant to support their request. The review must be completed within 45 days of the request, and the participant is notified in writing of the results. The State Director

may require that the decision be reviewed by the next-level supervisor or other designated Rural Development staff before the participant is notified of the decision. **Attachment 1-D** will be used if the adverse decision is not reversed as a result of the informal review. If the decision is reversed, a letter will be sent to the participant notifying them of the decision and next steps.

Participants may skip an informal review and, if applicable, request mediation, ADR, or a NAD appeal. In doing so, participants automatically waive their rights to an informal review.

D. Mediation or ADR

Adverse decisions that are appealable to NAD also require that the participant be given the opportunity to seek mediation or ADR prior to having a hearing with NAD. The purpose of mediation or ADR is to resolve disputes through the use of a neutral mediator. State Directors may wish to consider issuing a State Supplement, outlining the coordination required between the Field Office and State Office on handling mediation and ADR requests.

Participants may skip mediation or ADR and request a NAD appeal. In doing so, they automatically waive their rights to mediation or ADR.

1. Requests for Mediation or ADR

After receiving **Attachment 1-B** or **1-D**, a program participant may request mediation or ADR services. Upon receipt of the program participant's request for mediation or ADR, **Attachment 1-E, 1-G, or 1-H** is sent to the participant to start the process. The Attachment used depends upon whether the state in which the action applies is covered by a USDA-sponsored mediation program. These Attachments are generally sent by the State Director since costs are involved; however, they can be sent directly by the Field Office at the discretion of the State Director.

2. Cost of Mediation or ADR

There are generally costs associated with participation in mediation or ADR. When there are costs, they will be shared equally between the Agency and the program participant, if Agency funds are available. Where Agency funds are not available, the Agency will participate in mediation or ADR if requested by the program participant; however, the program participant will be notified in advance of the portion of the cost that the Agency will pay (if any) and their estimated cost for this service. The State Director will ensure that all participants requesting mediation or ADR in their state are treated consistently and pay the same percentage of the cost toward this service. The State Director may also consent to pay a larger percentage (up to 100 percent) of the cost of mediation or ADR for participants with incomes below the poverty level. The Agency will notify the mediation or ADR sources of how the cost of such service will be paid. **Attachments 1-E, 1-F, 1-G**, and **1-H** include language to meet this requirement.

3. Mediation in States with a USDA-Sponsored Mediation Program

Many states have a USDA-sponsored mediation program. These programs are funded, in part, by USDA and were established primarily to mediate cases originating from the Farm Service Agency (FSA). If program participants are unsure if a USDA mediation program exists in their state, they should contact their State Director. In states with a USDA-sponsored mediation program, program participants who are provided appeal rights generally will be referred to the USDA-sponsored mediation program. ADR is not applicable in these states. **Attachment 1-E** may be sent to the program participant to acknowledge their request, and **Attachment 1-F** may be used to refer the case to the USDA-sponsored mediation program. In states where alternative mediation sources are readily available at a lower cost than the USDA-sponsored mediation program, the state will follow the guidance for states without a USDA-sponsored mediation program, and include the USDA sponsored mediation program on the list of acceptable providers.

4. Mediation or ADR in States without a USDA-Sponsored Mediation Program

In states without a USDA-sponsored mediation program, Agency officials are responsible for maintaining a list of mediators or ADR providers. The State Office will generally maintain this list as program participants are referred to the State Director to initiate mediation or ADR. FSA can generally provide a list of acceptable mediation or ADR sources in a state. Other contacts include the American Association of Arbitrators (AAA) or State bar association. When making contacts with these sources, the Agency must request the services of a mediator and not an arbitrator. (A mediator resolves disputes by negotiating a resolution through mutual agreement; an arbitrator resolves disputes through hearing both parties and then rendering a binding decision and should not be used.) The list of mediators will contain the approximate cost of each service provider, if known. States may handle the list of mediation and ADR sources as follows:

- The state may select a mediator or ADR provider from the list, provided there is not a significant variation in the cost of service providers. The list will be maintained alphabetically and sources selected in sequential order. **Attachment 1-G** may be sent to the program participant to acknowledge their request for mediation or ADR, and **Attachment 1-F** may be used to refer the case to the provider. States will need to maintain documentation to ensure that mediators and ADR providers receive an equal number of referrals. If there is a significant variation in cost among service providers, this option will not be used.

- The state may provide the list of mediators or ADR providers to the participant and request the participant to select the source or provide the name of another acceptable source of mediation or ADR. The list will contain the approximate cost of each service provider, if known. **Attachment 1-H** is used for this purpose and provides the participant with <u>10 days</u> to select a service provider. After selection, **Attachment 1-F** will be used to refer the case to the mediator or ADR provider. If the program participant does not provide the name of a mediator or ADR provider within <u>10 days,</u> their request for mediation or ADR will be considered withdrawn. Withdrawal or

cancellation of mediation or ADR does not extinguish the participant's right to an appeal with NAD.

5. Timing of mediation or ADR

Mediation or ADR must be completed within 45 days after the case is referred to the mediation or ADR source, unless the complexity of the case warrants a longer time frame and all parties agree to a specific time frame. A mediator or ADR provider will generally conduct a teleconference between the parties prior to accepting a case to determine if the case can be mediated. The Agency encourages the use of a pre-mediation conference since many adverse decisions in the Multi-Family Housing program may not lend themselves to mediation. Regardless, the Agency will not refuse to participate in mediation or ADR if requested to do so by the program participant.

Mediation or ADR occurs prior to having a hearing with NAD. Requests for mediation or ADR made prior to filing an appeal with NAD stop the clock on the 30-day period during which a participant may appeal to NAD. After mediation or ADR has concluded, any days that remain from the 30-day period are available to the participant to request an appeal to NAD. **Attachment 1-I** is used for this purpose. The person completing **Attachment 1-I** will need to determine the number of days the participant took to request mediation or ADR. Hearing dates for participants who request mediation or ADR after filing an appeal must be selected with 45 days of the conclusion of mediation or ADR. Participants may also request mediation or ADR after filing an appeal with NAD but prior to the hearing.

E. Appeal

Participants who wish to appeal an adverse decision must submit a written request to NAD within 30 days of receiving notice of an adverse decision. The request must be signed by the participant and include: (1) a copy of the adverse decision to be appealed; and (2) a brief statement describing why the participant believes the decision is wrong.

Upon receiving a notice from NAD that an appeal has been filed, the Field Office will promptly provide NAD with a copy of the Agency record, specific references in 7 CFR Part 3560 to support the adverse decision, and any other pertinent information. A copy will also be provided to the program participant.

In accordance with NAD regulations, the program participant has the right to a face-to-face hearing in the participant's state of residence. The program participant also has the right to request that the hearing be handled by teleconference. An adverse decision made by the Agency may result in an appeal hearing and require a face-to-face hearing. In these cases, the Appeal Coordinator may request the State Director to provide Field Staff to attend the hearing and represent the Agency. The Appeals Coordinator will provide sufficient documentation and phone resources to the person selected by the State Director to adequately represent the Agency in the case.

NAD will notify the participant and the Agency once it has made a final determination. If NAD reverses the Agency's decision, the next loan processing action

that would have occurred had no adverse decision been made must be taken within 30 days after the effective date of the notice from NAD; unless the Agency requests a review of the case by the Director of NAD. See **Appendix 2** for more guidance on Director Reviews and other information regarding appeals.

F. Tenants and the Tenant Grievance Process

The Agency has a formal process for resolving tenant grievances. Tenants and applicants for tenancy may file complaints and may be entitled to a hearing, depending on whether the grievance is legitimate and whether it can be resolved through informal means. Tenant grievance procedures are discussed in detail in Chapter 6, Section 8 of this handbook.

1.9 CONFLICT OF INTEREST *[7 CFR 3560.10]*

All Agency employees must strive to maintain the highest levels of honesty, integrity, and impartiality in conducting their activities on behalf of the Agency. The Agency's conflict of interest requirements are described in RD Instruction 1900-D. To reduce the potential for conflicts of interest, all processing, approval, servicing, or review activity must be conducted by Agency employees who:

- Are not the recipient (applicant or borrower), a recipient's family member, or a close known relative of the recipient;
- Do not have an immediate working relationship with the recipient, the Agency employee related to the recipient, or the Agency employee who would normally conduct the activity; and
- Do not have a business or close personal association with the recipient.

A. Applicant Disclosure

Applicants must disclose any known relationship or association with Agency employees when they apply.

B. Agency Employee Disclosure

Agency employees must disclose any known relationship or association with a recipient, regardless of whether the relationship is known to others. Loan Servicers should notify a supervisor after the application is accepted but before any eligibility determination is made.

1.10 OTHER FEDERAL REQUIREMENTS

A. Environmental Requirements *[7 CFR 3560.3]*

The Agency considers environmental quality equally with economic, social, and other factors in its program development and decision making processes. Both the Loan Originators and Loan Servicers are responsible for effectively integrating Agency environmental policies and procedures with loan and grant origination and servicing activities. It is particularly important for Loan Servicers to be aware of environmental requirements concerning sites, especially during the liquidation process, when the Agency needs to ensure that it will not acquire property with an environmental liability. The Loan Servicer should also be aware of mitigation measures contained in the Agency's environmental review. Where mitigation measures require an on-going effort of owner and management (such as maintaining the condition of a historic building or not building on portions of the site) these should be a part of servicing. Agency environmental policies and procedures and historic preservation requirements can be found in RD Instruction 1940-G and 1904-G. Agency-assisted properties must meet current Agency guidance on lead-based paint requirements and 1904-G.

B. Construction Standards

Sites and dwellings developed or rehabilitated with Section 515 or Section 514/516 funds must meet the construction standards described or referenced in RD Instructions 1924-A and 1924-C. Existing dwellings must be decent, safe, and sanitary and must meet all applicable state and local codes.

C. Lobbying Restrictions

RD Instruction 1940-Q prohibits applicants and recipients of Agency assistance from using appropriated funds for lobbying the Federal Government in connection with a specific award. This Instruction also requires that entities that request or receive loans or grants must disclose the expenditure of any funds, other than appropriated funds, for lobbying activities using Exhibit A-1 from RD Instruction 1940-Q.

D. Administrative Requirements

Agency employees must comply with Agency and departmental administrative requirements.

1. Procurement

Goods and services procured to support Agency activities such as appraisals, inspections, broker services, and property management services must conform with the policies and procedures of RD Instruction 2024-A.

2. File Management

Files and other Agency records must be maintained in accordance with RD Instruction 2033-A. Additional information is provided in Chapter 9.

3. Handling Funds

Project funds must be handled in accordance with RD Instruction 1902-A.

1.11 EXCEPTION AUTHORITY *[7 CFR 3560.8]*

Exceptions to any requirement of this handbook or 7 CFR Part 3560 may be approved in individual cases by the Administrator if application of the requirement or failure to take action would adversely affect the Government's interest or conflict with the objectives and spirit of the authorizing statute. Any exception must be consistent with the authorizing statute and other applicable laws.

Requests for exceptions are submitted to the Administrator, through the Deputy Administrator, Multi-Family Housing, and may be initiated by the State Director; the Director, Multi-Family Housing Processing Division; or the Director, Multi-Family Housing Portfolio Management Division.

The exception request must provide clear and convincing evidence of the need for the exception. At a minimum the request must include:

- A full explanation of the circumstances, including an explanation of the adverse effect on the Government's interest;
- A discussion of proposed alternatives considered; and
- A discussion of how the adverse effects will be eliminated or minimized if the exception is granted.

Requests to the Administrator for exceptions regarding architectural, environmental, or civil rights issues will include the review and comments of the appropriate National Office Staff.

ATTACHMENT 1-A

EQUAL CREDIT OPPORTUNITY ACT (ECOA)

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, martial status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this assistance is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-B

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT IS APPEALABLE

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe this decision or the facts used in this case are in error, you may pursue any or all of the following three options.

Option 1 - Informal Review

If you have questions concerning this decision or the facts used making it and desire further explanation, you may write this office to request an informal review. ***There is no cost for an informal review.*** This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review. You may skip this step in the informal process and select one of the following two options. If you do, you will automatically waive your right to an informal review.

Option 2 - Mediation or ADR

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need the information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to such service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 3). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 3.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 3 - Request an Appeal

You may request an appeal hearing by the NAD rather than an informal review, mediation, or ADR. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

Your request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 2.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file,

any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, because of race, color, religion, sex, disability, familial status, or national origin. The federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-C

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF AN ADVERSE DECISION THAT CANNOT BE APPEALED

The decision described in the attached letter did not grant you the assistance you requested or will terminate or reduce the assistance you are currently receiving.

If you have questions concerning this decision or the facts used in making it and desire further explanation, you may write this office to request an informal review. This written request must be received no later than 15 calendar days from the date of the attached letter. You must present any new information, evidence, and possible alternatives along with your request. You may also have a representative or legal counsel participate in the process, at your cost. The informal review may be conducted by telephone or in person, at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review.

Applicants and borrowers generally have a right to appeal adverse decisions, but decisions based on certain reasons cannot be appealed. We have determined that reasons for the decision cannot be appealed under our regulations. You may, however, write the Assistant Director with the NAD for a review of the accuracy of our finding that the decision cannot be appealed. Your request must be made no later than 30 days from the date you receive the attached letter.

NAD Assistant Director address:

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580.

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1 - D

ATTACHMENT TO LETTER NOTIFYING CUSTOMERS OF UNFAVORABLE DECISION REACHED AS A RESULT OF AN INFORMAL REVIEW

We appreciated the opportunity to review the facts relative to your request for assistance. We regret that the decision in the attached letter did not grant the assistance you requested or will terminate or reduce the assistance you are currently receiving. If you believe that facts used in this case are in error, you may pursue any or all of the following two options.

Option 1 - Mediation or ADR

You have the right to request mediation or other forms of ADR for the issues that are available for mediation. ***You will have to pay for at least 50 percent of the cost of mediation or ADR.*** Rural Development will pay for the other 50 percent of the cost, provided the Agency has sufficient resources from its appropriated funds. If the Agency does not have sufficient resources, you will be advised how much, if any, the Agency can contribute to the cost of mediation or ADR. If you need information to assist you in deciding whether to seek mediation or ADR, you may contact the Rural Development State Director listed below.

If you elect to seek mediation or ADR, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of the attached letter. The Rural Development State Director will advise you of the estimated cost of mediation or ADR, the extent to which the Agency can contribute to the cost, and the process and procedures for this service. In states with a USDA-sponsored mediation program, you will generally be referred to this service. In states without a USDA-sponsored mediation program, you will be provided with the name or names of mediators. You will be advised directly by the mediation or ADR source if they can mediate your case. Once you request mediation or ADR, it stops the running of the 30-day period in which you may request an appeal (described in Option 2). If mediation or ADR does not result in resolution of these issues, you have the right to continue with a request for an appeal hearing as set forth in Option 2.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the National Appeals Division (NAD); however, an NAD appeal hearing would take place after mediation or ADR. You may skip mediation or ADR and request an appeal hearing. However, in doing so, you will automatically waive your rights to an informal meeting, mediation, or ADR.

Rural Development State Director address:

Option 2 - Request an Appeal

You may request an appeal hearing by the NAD rather than an informal review or mediation. ***There is no cost for an appeal.*** Your request for an appeal must be made no later than 30 days from the date you receive the attached letter. You must write the Assistant Director, NAD, for your region at the following address:

NAD Assistant Director address:

The request for an NAD hearing must state the reasons why you believe the decision is wrong, be personally signed by you, and must include a copy of the attached letter. A copy of your request must also be sent to the Rural Development State Director at the address listed under Option 1.

You have the right to an appeal hearing within 45 days of the receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing, you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file, any written statements or evidence you may provide and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant’s income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance

with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

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ATTACHMENT 1-E

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION IN STATES WITH A USDA-SPONSORED MEDIATION PROGRAM

This replies to your request for mediation or alternative dispute resolution services. The state in which you requested assistance has an impartial USDA-sponsored mediation program available. Your request for mediation has been sent to:

You will be contacted directly by the USDA-sponsored mediation program to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for mediation services. The cost estimated for this service is:

> $ _____ You will be advised directly by the USDA-sponsored mediation program of the full cost of mediation. This is only an estimate and may vary depending on the issues and complexity of the case. If you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored program to cancel your request

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cast will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have financial resources for these services. You must pay the full cost of mediation from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation is concluded, you will be notified of the results and the number of days remaining to request an appeal, if applicable. If you request mediation prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the adverse decision minus the number of days you took to request mediation. Mediation does not take the

place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation.

Remember, if you decide not to pursue mediation, you must immediately contact this office and the USDA-sponsored mediation program to cancel your request. You will be responsible for any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-F

ATTACHMENT FOR REQUESTING MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) SERVICES

TO:

FROM:

SUBJECT: Request for Mediation or ADR Services

CUSTOMER:

The above-subject Rural Development customer has received an adverse decision from our Agency and has requested mediation or ADR services. Attached is a copy of the adverse decision letter and the customer's request for your service.

Informal Review:

___ The customer was provided with the opportunity for an informal review with the Agency; however, chose not to exercise this option.

___ An informal review was conducted; however, the Agency did not reverse its decision.

___ This case is under the jurisdiction of our State Office.

Payment for Service:

___ The customer and Agency will split the cost of this service 50/50.

___ The customer will pay the full cost of mediation or ADR.

___ The Agency will pay _____ towards mediation or ADR. The customer will pay the balance.

If the Agency is paying for any portion of the cost of this service, the bill for the Agency's portion should be submitted to this office. The customer is solely responsible for their portion of the cost of this service and should be bill directly.

Jurisdiction of case:

___ The adverse decision in this case was made by the following office. You should contact this office for further information on the case:

___ The adverse decision in this case was made by the ___[insert appropriate name]___. You may contact the Appeals Coordinator for further information on the case and to arrange for mediation or ADR:

USDA, Rural Development

Appeals Coordinator

ATTN: _____

_____, _____ _____

(___) ___-____, extension _____

Mediation or ADR must be completed within 45 days; unless the complexity of the case requires a longer time frame and all parties agree to a specific time frame. We also request a teleconference prior to your acceptance of this case to determine if the adverse decision lends itself to mediation or ADR.

ATTACHMENT 1-G

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF SERVICE PROVIDER

This replies to your request for mediation or alternative dispute resolution services. Your request has been sent to:

You will be contacted directly by the above to determine if they can mediate the issues in your case.

As indicated in our adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

> $ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to the NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office and the mediation or ADR provider to cancel your request. You will be responsible for

any costs incurred by the mediation or ADR source up until the time of your cancellation. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-H

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT REQUEST MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) OF POTENTIAL SERVICE PROVIDERS

This replies to your request for mediation or ADR services. Attached you will find a list of mediation and ADR providers. You will need to select one of the sources from the list, or you may provide the name of another independent mediation or ADR source. You must provide this office, in writing, with the name of the provider within 10 days. Rural Development will then contact the source and provide photocopies of the adverse decision letter and any other relevant information. We will also request that the mediation or ADR provider conduct a teleconference between the parties.

If we do not receive your selection of a mediator or ADR provider within 10 days, we will consider such inaction to be your notice to cancel your request for mediation or ADR. You may continue to pursue an appeal to the NAD as outlined in our original adverse decision letter.

As indicated in our original adverse decision letter, there may be a cost for these services. The estimated cost for this service is:

> $ _____ You will be advised directly by the mediation or ADR source of the full cost of this service. This is only an estimate and may vary depending upon the issues and complexity of the case. If you decide not to pursue mediation or ADR, you must immediately contact this office and the above-mentioned mediation or ADR provider.

Rural Development will:

> _____ Contribute 50 percent towards the cost. The balance of the cost will have to be paid from your own resources.
>
> _____ Cannot contribute towards the cost as the Agency does not have the financial resources. You must pay the full cost from your own personal resources.
>
> _____ Contribute _____ towards the cost. The balance of the cost will have to be paid from your own personal resources.

When mediation or ADR is concluded, you will be notified of the result and the number of days remaining to request an appeal, if applicable. If you request mediation or ADR prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date you received notice of the adverse decision minus the number of days you took to request mediation. Mediation or ADR does not take the place of, or limit your rights to, an appeal to NAD; however, an NAD appeal hearing would take place after mediation or ADR.

Remember, if you decide not to pursue mediation or ADR, you must immediately contact this office to cancel your request. Canceling your request for mediation does not affect your rights to seek an appeal with the NAD as discussed in our original decision letter.

ATTACHMENT 1-I

ATTACHMENT FOR NOTIFYING CUSTOMERS THAT MEDIATION OR ALTERNATIVE DISPUTE RESOLUTION (ADR) DID NOT RESULT IN RESOLUTION OF ISSUES

We regret that we are unable to grant the assistance you requested or will terminate or reduce the assistance you requested. Mediation or ADR did not result in resolution of the issues.

If you believe the decision or facts used in the case are in error, you may pursue your right to an appeal by the NAD. ***There is no cost for an appeal.*** The number of days in which you have to request an appeal depends upon whether you previously requested an appeal to NAD prior to entering into mediation or ADR. ***Please follow the guidance in the paragraph indicated with an "X".***

___ You requested an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address to schedule the appeal hearing:

NAD Assistant Director address:

___ You did not request an appeal hearing to NAD prior to entering into mediation or ADR. You must write to the Assistant Director of NAD at the following address. Your request must be postmarked within ____ days from receipt of this letter. This represents the difference between 30 days and the number of days you took after the adverse decision to request mediation or ADR. Use the NAD Assistant Director address is listed above.

Information regarding appeals

You have the right to an appeal hearing within 45 days of NAD's receipt of your request. You or your representative or counsel may contact this office anytime during regular office hours in the 10 days following the receipt of your request for a hearing to examine or copy relevant non-confidential material in your file. Photocopies will be provided to you. Your representative or counsel should have your written authorization to represent you and review your file.

The NAD Hearing Officer will contact you regarding a time and place for the hearing. You may also request a teleconference hearing in lieu of the face-to-face hearing. At any time before the scheduled hearing you may also request that the Hearing Officer make a decision without a hearing. If you do, the Hearing Officer's decision will be based on the Rural Development file,

any written statements or evidence you may provide, and any additional information the Hearing Officer thinks necessary.

The Federal ECOA prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The Federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington, D.C. 20580

The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms of conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U. S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact the U. S. Department of Housing and Urban Development, Washington, D.C. 20410 or call (800) 669-9777.

cc: NAD Assistant Director

CHAPTER 2: MULTI-FAMILY HOUSING PROGRAMS AND ASSET MANAGEMENT

2.1 INTRODUCTION

This chapter introduces key aspects of the Section 515 Multi-Family Housing and Section 514/516 Farm Labor Housing programs. Under these programs, the Agency provides direct loans and grants to support the development of affordable rental housing that serves rural areas. The Section 538 Multi-Family Housing Guarantee program—the Agency's third Multi-Family Housing Program that guarantees loans made by private lenders—is covered in a separate regulation, *[7 CFR Part 3565]* and handbook (HB-1-3565).

This chapter also presents the asset management framework that the Agency uses to oversee borrower performance in meeting their responsibilities under the program. The framework provides Loan Servicers with a consistent basis for ensuring that borrowers' operation of projects meets the objectives of the program and complies with applicable program requirements.

Section 1 introduces the types of loans and other forms of assistance available through the Section 515 program and the Agency's objectives in providing this assistance. Section 2 describes the loans, grants, and other assistance available to increase the supply of affordable housing specifically targeted toward farm labor. The chapter concludes with Section 3, which outlines the Agency's asset management framework, as well as the key parties involved.

SECTION 1: SECTION 515 PROGRAM

2.2 OVERVIEW

The Section 515 program offers direct loans to eligible borrowers to provide economically designed and constructed housing and related facilities for very low-, low-, and moderate-income households; elderly households; and persons with disabilities living in rural areas. This section of the chapter describes:

- The types of projects allowed;
- The types of loans available;
- Rental assistance available from the Agency; and
- The Agency's preference for leveraged projects.

2.3 TYPES OF PROJECTS

There are five types of rental projects that can be developed using Section 515 loans:

- Family projects;

- Elderly projects;
- Congregate projects;
- Group homes; and
- Rural cooperative housing.

The housing must be economical and must not include elaborate features, but must be adequate to meet tenants' needs. The project should be of average quality and cost. With the exception of off-farm labor housing, all projects must be developed in locations that qualify as rural areas.

A. Family Projects

A family housing project is a rental property developed for occupancy by eligible very low-, low-, and moderate-income households. Nonelderly and elderly households may occupy the housing. Household income is the only tenant characteristic, except under extraordinary circumstances such as tenant displacement, which is given preference in selecting among eligible applicants for occupancy. Priority is also given to those needing features of an accessible unit if one becomes available. Occupancy may not be restricted to particular groups of eligible households and may include elderly households.

B. Elderly Projects

An elderly project is a rental property that is developed for occupancy solely by eligible elderly households, which include a tenant or cotenant who is disabled or age 62 years or older. Persons with disabilities and their families are permitted to live in elderly housing.

C. Congregate Projects

Congregate projects are rental properties developed for occupancy by eligible very low-, low-, or moderate-income elderly households, individuals with disabilities and families who require some supervision and central services but are otherwise able to care for themselves. Congregate projects consist of private apartments and central dining facilities in which a number of allowable preestablished services are provided to tenants. These projects are not designed to be nursing homes and, therefore, are not allowed to pay for the cost of medical- or healthcare-related services. When leasing units, priority may be given to eligible elderly households who qualify for the services provided by the facility.

D. Group Homes

A group home is housing that is occupied by eligible very low-, low-, and moderate-income elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

E. Rural Cooperative Housing

Section 515 loans may be used to finance rural cooperative housing projects operated by nonprofit consumer cooperatives for the benefit of eligible very low-, low-, and moderate-income members, who will own and manage the project.

2.4 TYPES OF LOANS

The rules governing the origination of Section 515 loans differ slightly, depending upon the type of loan being made. The types of loans available under Section 515 include:

- Initial loans;
- Subsequent loans; and
- Assumed loans.

Loans are only made to projects that further the program's objectives and comply with applicable Agency requirements.

A. Initial Loans

Initial loans are made to projects with no existing Agency loan. Most initial loans are made to build new properties. However, the Agency does make initial loans for rehabilitation of existing properties when it is in the Agency's best interest.

The interest rate for these loans is set at the note rate established in RD Instruction 440.1. The Agency then provides interest credit assistance, which reduces the effective interest rate to 1 percent[1]. Interest credit is only provided for units occupied by eligible tenants paying at least 30 percent of their income for rent. The administration of interest credit is covered in Chapter 7 and also in HB-3-3560.

The Agency establishes the term of these loans to correspond to the expected useful life of the property. The maximum term is 30 years with a 50-year amortization period. .

[1] Some existing projects do not receive interest credit, while others receive interest credit that reduces the interest rate to three percent. However, all initial loans made by the Agency following the publication of this handbook will receive interest credit as described here.

B. Subsequent Loans

Subsequent loans can be issued during the term of an Agency loan to help an existing borrower pay for repairs or improvements to the property or in conjunction with the transfer of a property where the purchaser is assuming the initial Agency loan. The key differences between processing requirements for subsequent and initial Section 515 loans are discussed in Chapter 11 of HB-1-3560. Guidance regarding the requirements and procedures for processing project transfers is covered in the HB-3-3560. Subsequent loans may also be used to finance equity to avert prepayment of the project.

C. Assumed Loans

Section 515 loans may be assumed in conjunction with the transfer of ownership of the property. The terms and conditions of the assumption depend upon the needs of the project at the time of the transfer.

1. New Rates and Terms Assumption

Most assumptions of Section 515 loans are new rates and terms assumptions—that is, the purchaser assumes responsibility for all or a portion of the remaining debt. To conserve the Agency's budgetary resources, the transaction does not involve paying off the old loan and issuing a new initial loan. Instead, the purchaser assumes the outstanding debt, which is reamortized at new rates and terms. New rates and terms assumptions are used when the purchaser will experience financial difficulties under the terms of the initial loan or when a change in rates and terms is necessary to facilitate the transfer. Purchasers may apply for subsequent loans to make up the difference between the amount of debt assumed and the purchase price or to address physical needs at the project.

2. Same Rates and Terms Assumption

Transfers may also take place in conjunction with a same rates and terms assumption. Under this type of assumption, the existing note terms, including the interest rate and the remaining repayment period, do not change.

2.5 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

To maximize the number of units produced with Section 515 loan funds, the Agency gives preference to project applications for new loans that leverage other funds, thereby reducing the amount of Section 515 loan funds needed to develop the project. The greater the leveraging proposed in a project application, the greater the preference for funding. Examples of funds that count as leveraged funds include borrower resources beyond the minimum required amount, equity generated by the sale of low-income housing tax credits (LIHTCs), a second loan from another lender, or a grant from a state or local public agency or other source.

SECTION 2: Section 514/516 Program

2.6 TYPES OF PROJECTS

The Section 514/516 Farm Labor Housing program provides funds to support the development of housing for farm labor. Section 514/516 assistance differs from the Section 515 loans in the following ways:

- The objective of the program is to provide housing for farmworkers;
- There are no rural restrictions; and
- Agency grants are available to support the development of these projects.

Section 514/516 assistance may be used for Off-Farm Labor Housing projects. On-Farm Labor Housing projects may receive only 514 assistance. They are not eligible for grants (Section 516). Section 514 assistance may be used in conjunction with Federal LIHTCs.

A. Off-Farm Labor Housing

The Agency is authorized to make loans and grants for financing off-farm labor housing to broad-based nonprofit organizations; nonprofit organizations of farmworkers; Federally-recognized Indian tribes, agencies or political subdivisions of state or local government; and public agencies (such as local housing authorities). Section 514 loans can be made to limited partnerships in which the general partner is a nonprofit entity.

B. On-Farm Labor Housing

On-farm labor housing is designed to provide adequate housing for farmworkers involved in a specific farming operation. Individual farmers, family farm corporations or partnerships, or associations of farmers may develop these projects but must operate them on a nonprofit basis. To qualify for occupancy, an individual or a household must simply be employed as part of the farming operation. There is no income restriction governing occupancy. However, immediate family members of individuals with an ownership interest in the farm are prohibited from living in this housing on the property.

2.7 LOANS AND GRANTS

A. Farm Labor Housing Loans

Section 514 loans for Farm Labor Housing projects are very similar to Section 515 loans. However, they differ in two important ways:

- These loans carry a 1 percent effective interest rate (i.e., there is no interest credit); and
- The maximum term for these loans is 33 years.

These loans can be used to finance either Off-Farm or On-Farm Labor Housing projects.

At one time, loans for both types of projects were processed on a first-come, first-served basis. Today, lending decisions regarding loans for Off-Farm Labor Housing projects are handled through a competitive NOFA process, while loans for On-Farm Labor Housing projects are still processed in the order that they are received. Chapter 12 of HB-1-3560 provides more detailed information about the origination process for Farm Labor Housing loans.

B. Farm Labor Housing Grants

Section 516 grants may only be used to support the development of Off-Farm Labor Housing projects. These grants may be used for the same purposes as Section 514 loans when there is reasonable doubt that the housing would not be provided without the grant. Chapter 12 of HB-1-3560 provides more information about the origination process for these grants.

2.8 PREFERENCE FOR PROJECTS THAT LEVERAGE OTHER FUNDS

Like the Section 515 program, the Agency gives preference to applications for Off-Farm Labor Housing projects that leverage other sources of funds. There is no leveraging preference for On-Farm Labor Housing applications.

SECTION 3: SECTION 521 PROGRAM

2.9 OVERVIEW

The Section 521 Rental Assistance program provides assistance to individual residents of Agency financed multi-family projects. Rent subsidies under the Rental Assistance Program ensure that elderly, disabled, and low-income residents of multi-family housing projects financed by RHS are able to afford rent payments. With the help of the Rental Assistance Program, a qualified applicant/tenant pays no more than 30 percent of his or her income for housing.

Residents of multi-family housing projects built under both the Rural Rental Housing Program (Section 515) and the Farm Labor Housing Program (Section 514) are eligible to apply for the Rental Assistance Program. Not all residents of RHS-financed housing developments receive rental assistance.

The Agency and the project owner execute a contract in which the Agency commits payments on behalf of tenants in a designated number of the units. Both the Agency and the project owner agree to be bound by all applicable Agency regulations. The contract becomes effective on the first day of the month in which it is executed (additional units may be covered if funds are available and an additional contract is executed). The agreement may be renewed as many times as funds are made available. State Directors may transfer unused and unneeded contracts or portions of contracts to other projects.

2.10 SECTION 515 & 514/516 PROGRAM

A. Section 515

Owners of Section 515 projects located in areas where prospective applicants are likely to be overburdened by rent or where existing tenants are already overburdened can apply for rental assistance administered by the Agency.

B. Section 514/516

Off-Farm Labor Housing projects may also apply for rental assistance administered by the Agency. The requirements for obtaining rental assistance are the same as for Section 515 projects. Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under Section 514 or Section 516 that serve migrant farm workers. On-Farm Labor Housing projects are not eligible for rental assistance.

SECTION 4: ASSET MANAGEMENT FRAMEWORK

2.11 ASSET MANAGEMENT

The goal of the Agency's asset management procedures is to ensure that projects receiving Agency financing operate in a manner consistent with the program's objectives and comply with applicable requirements. Accordingly, this handbook covers the following aspects of project operation and oversight:

- Project Management;
- Financial Management;
- Physical Condition of the Project;
- Project Occupancy;
- Project Rents; and
- Rental Subsidies.

It presents the program requirements in each of these areas and describes the Agency's procedures for monitoring properties to ensure that borrowers, their agents, and tenants are fulfilling their responsibilities.

In addressing each topic area, the handbook first presents the requirements and procedures for Section 515 rental projects and then discusses differences or additional requirements for other types of projects (e.g., congregate housing, Farm Labor housing, cooperatives).

2.12 KEY ASSET MANAGEMENT ACTIVITIES AND DOCUMENTS

A. Key Agency Activities

The Agency uses the same basic procedures to oversee the performance of all types of multi-family housing projects that it directly finances. While the Agency's oversight activities are essentially the same for all types of projects, the aspects of borrower performance examined during these activities will vary by type of project due to differences in requirements.

Asset Management

Asset management refers to Agency oversight of project performance to ensure that operation of the property furthers the program's objectives and complies with applicable Agency requirements.

Agency oversight activities fall into three major categories:

- Oversight of new projects or borrowers;
- Annual oversight activities; and
- Periodic oversight activities.

The specific activities in each category are summarized in Exhibit 2-1.

Exhibit 2-1

Key Asset Management Activities

Agency Actions for New Projects:

- Conduct pre-occupancy meeting;
- Conduct post occupancy review;
- Review project worksheets; and
- Review of quarterly/monthly reports.

Annual Agency Actions:

- Review project worksheets;
- Review of project annual financial report;
- Annual review of project reserve account (new);
- Annual physical review;
- Review and approval of project budget for the coming year;
- Respond to evidence of potential compliance concerns (e.g., substantiated tenant complaints, reports by other Agency staff or offices, information provided by public or other agency); and
- Respond to servicing requests from borrowers.

Periodic Agency Actions:

- Perform physical inspection of project;
- Perform occupancy review of project;
- Perform supervisory visit; and
- Conduct compliance reviews.

All of the above require follow-up to address deficiencies.

B. Key Documents

Borrowers' responsibilities under the program and evidence that they are complying with program requirements are established through program loan and grant documents. The key program documents used in Agency asset management activities are listed in Exhibit 2-2.

Exhibit 2-2

Key Program Documents

- Mortgage or deed of trust;
- Promissory Note;
- Loan agreement/resolution;
- Grant agreement;
- Interest credit and rental assistance agreement;
- Rental assistance agreement;
- Management plan;
- Management certification;
- Management agreement;
- Affirmative Fair Housing Marketing Plan;
- Project worksheet;
- Utility allowance documentation;
- Tenant certification;
- Dwelling lease;
- Project budget;
- Annual financial report for project; and
- Agency Monitoring Forms.

2.13 ASSET MANAGEMENT PROCEDURES FOR MULTI-FAMILY HOUSING PROJECTS

Chapters 3 through 9 describe the program requirements for Section 515 and 514/516 projects.

A. Property Management (Chapter 3)

Borrowers must comply with a number of program requirements regarding general project management functions. The borrower's plans for project management are documented in management documents (the management plan and management entity profile). The Agency must also approve the project's management agent and review management fees for reasonableness.

B. Financial Management (Chapter 4)

Borrowers must establish project financial management systems and procedures that reflect the complexity of project operations and provide adequate supervision to ensure that program objectives are met. The Agency has specific requirements regarding project accounting, budgeting, financial reporting, and project annual financial reports. The borrower's accounting system identified in the management plan must comply with the Agency's chart of accounts. The Agency will monitor project accounts through project reports and monitoring visits to the site. The Agency approves the budget on an annual basis and reviews financial reports on an ongoing basis.

C. Project Physical Conditions (Chapter 5)

Borrowers are responsible for maintaining their projects' physical conditions to meet program standards for decent, safe, and sanitary housing. Loan Servicers will monitor the quality of the housing through regular physical inspections of the property as well as through the budget process. The Agency will review the borrower's capital budget planning and approve reserve withdrawals for capital improvements. In the event that a borrower fails to meet program standards, Loan Servicers are responsible for ensuring that the borrower takes appropriate actions to correct physical deficiencies.

D. Project Occupancy (Chapter 6)

Loan Servicers will monitor borrowers' compliance with program occupancy rules, ensuring that tenant eligibility requirements are observed and occupancy policies are consistently followed. The borrower must market the project to all eligible applicants and process applications, select tenants, and assign units in a fair and consistent manner. Borrower must also observe Agency rules regarding dwelling leases, tenant recertification, termination of occupancy, and tenant grievance procedures. Loan Servicers will check compliance with these requirements through regular reports and monitoring visits to the site.

E. Rents, Shelter Cost, and Utility Allowances (Chapter 7)

Loan Servicers will review projects to ensure that the borrower establishes appropriate rents, occupancy charges, and utility allowances for individual units and, on an annual basis, review budgets to approve or deny requests for rent changes. Loan Servicers will also ensure that the borrower meets all requirements in handling the following:

- Tenant rent payments during evictions;
- Tenant security deposits; and
- Cases of tenant fraud.

F. Rental Subsidies (Chapter 8)

A multi-family housing project may have one or more types of rental subsidy including Agency rental assistance (RA), HUD Section 8, or other local forms of rental subsidy. Loan Servicers must ensure that borrowers comply with requirements to use RA appropriately. Only eligible projects, units, and tenants may receive rental subsidies. The borrower must enter into a rental subsidy agreement with the appropriate agency. Agency staff has administrative responsibilities for RA including suspending or transferring RA, replacing expiring RA agreements, and processing borrower requests for additional RA, modifying RA agreements and agency oversight of borrower performance.

G. Agency Monitoring (Chapter 9)

Loan Servicers must perform regular reviews of multi-family housing projects to monitor project performance and ensure compliance with program regulations and civil rights laws. Loan Servicers will make efforts to plan and prioritize monitoring activities to focus on the projects that need the most Agency attention. Borrowers will submit reports on an ongoing basis (either monthly or quarterly, as needed) to provide the Agency with much of the information needed to monitor project performance. However, Field Office Staff will also perform site visits as part of annual reviews, physical inspections, and supervisory visit.

CHAPTER 3: PROPERTY MANAGEMENT

3.1 INTRODUCTION

This chapter provides an overview of the essential responsibilities for property management. In general, the borrower is responsible for providing management acceptable to the Agency both in terms of staff qualifications and management practices. The borrower must ensure that property operations comply with the terms of all loan or grant documents; Agency requirements; and applicable local, state, and Federal laws and ordinances. For many project management responsibilities, the Agency must approve or concur in the management decisions and policies of the borrower. This chapter is designed to identify those actions that require Agency reaction to the borrower's decision.

Section 1 of this chapter deals specifically with property management, including Agency approval of the proposed management agent and management certification. It also describes the Agency's requirements regarding items that must be addressed in the borrower's management plan; and civil rights and accessibility requirements, self-evaluations, and transition plans.

Section 2 discusses the requirements for acceptable management entities and the Agency's procedures for reviewing and approving new management entities. It also outlines the Agency's procedures for removing unacceptable management entities.

Section 3 describes the program requirements regarding allowable management fees to be paid out of project income and Agency procedures for assessing the reasonableness of the fees.

Section 4 addresses the required insurance coverage and real estate taxes for projects.

Section 5 discusses the project management requirements and procedures that differ for Farm Labor Housing projects.

SECTION 1: PROJECT MANAGEMENT *[7 CFR 3560.102]*

3.2 OVERVIEW OF PROJECT MANAGEMENT RESPONSIBILITIES

Borrowers must provide management acceptable to the Agency as a condition of loan or grant approval. The borrower requirements listed in this chapter may be complied with by the borrower or a person designated in writing by the borrower. Acceptable management will be documented in the management plan and management certification.

3.3 THE MANAGEMENT PLAN *[7 CFR 3560.102(b)]*

For each multi-family housing project, borrowers must develop and maintain a management plan that establishes the systems and procedures that will be employed at the project to ensure that project operations comply with Agency requirements. This plan is used by the Agency to guide its oversight of project operations and its monitoring of project compliance. The management plan should provide the Agency with information regarding site operations only, not about management agent central office functions.

A management plan is initially submitted as part of the borrower's application for funding. It remains in effect until such time as the Agency requires modification of the plan, the plan needs to be updated to reflect changes occurring in project operations, or the project is transferred from one borrower to another.

A. New Projects

1. Requirements for Submitting a Management Plan

For new projects, borrowers must submit a management plan that addresses the required items identified in Attachment 3-A in sufficient detail to enable the Agency to effectively monitor project performance.

If the Agency determines that a proposed management plan does not adequately address the required items, Loan Processing Staff will provide written notice to the borrower indicating the deficiencies and specifying a time period for submission of an acceptable plan.

No Agency loan will be closed, construction started, or transfer approved before the Agency has an acceptable management plan from the borrower.

2. Contents of a Management Plan

At a minimum, management plans for multi-family housing projects must address the items presented in Attachment 3-A.

3. Agency Review of a Proposed Management Plan

In reviewing a proposed management plan, the Agency must ensure that it does not contain policies that violate Agency regulations and that it provides adequate details regarding the items in Attachment 3-A for the Agency to effectively monitor project compliance with program requirements.

B. Existing Projects

1. General Requirements for Maintaining and Modifying a Management Plan

In accordance with the requirements of this chapter, the borrower must develop and maintain a management plan acceptable to the Agency. A borrower's failure to maintain an acceptable plan is grounds for Agency termination of the management agent. This management plan will remain the guiding management document, as long as it accurately reflects project operations and the borrower remains in compliance with Agency rules and regulations.

Borrowers must submit an updated management plan to the Agency if project operations change and are no longer consistent with the current management plan on file with the Agency. The Agency should expect to see a modified management plan when:

- Project operations change to meet the needs of a changing tenant population;

- Program requirements change; or

- Changes in subsidy levels or types occur (e.g., HUD Section 8 is converted to Rental Assistance and/or units are reduced) or the property is converted to another allowable use (e.g., changed from a family property to an elderly property).

When a housing project is transferred from one borrower to another, the transferee must submit a new management plan that addresses the items listed in Attachment 3-A.

2. Agency Request for and Review of a Modified Management Plan

If the Agency determines that project operations are in compliance with Agency requirements; loan or grant agreements; or applicable local, state, and Federal laws but are not consistent with the management plan, the Agency will notify the borrower of the discrepancy in writing and indicate that the existing plan is no longer acceptable. Upon receiving notice that project operations are not consistent with the current management plan, borrowers must take one of the following actions within 60 days from the date of the Agency's letter:

- Revise the management plan to accurately reflect housing operations;

- Take actions to ensure that the management plan is followed; or

- Advise the Agency in writing of the action taken.

If the borrower submits a modified management plan, the Agency will review the plan for the necessary changes and ensure that the plan adequately addresses the requirements of the discrepancy. The Agency may visit the project or management agent's office to ensure that documented changes have occurred.

C. Three-Year Borrower Certification of Adequacy of Plan

When there have been no changes in a project's operations, borrowers must submit a certification to the Agency every 3 years stating that the project operations are consistent with the current management plan and that the plan is adequate to ensure project compliance with the loan documents and the applicable requirements of this part (see **Attachment 3-B**).

D. Projects with Compliance Violations

1. Agency Notification to the Borrower

If the Agency determines that there are compliance violations at a project, the borrower must respond to the Agency notification and update the management plan in accordance with the requirements below. If the borrower does not fulfill the requirements of this section, the Agency will deem the management plan for the project unacceptable, and the borrower/agent may be subject to termination of their management agreement.

2. Borrower Response to Agency Notification

Upon receiving notice of compliance violations at a project, borrowers must address the violations in accordance with 7 CFR 3560.102(d) and update the management plan as follows:

- Borrowers must submit to the Agency, within 60 days, revisions to the management plan that establish the changes in project operation that will restore project compliance; and

- If the borrower determines that changes to the management plan are not needed because the compliance violations were due to a failure to follow the current management plan, the borrower must certify to the Agency that the management plan is adequate to ensure project compliance with the applicable requirements of this part. Borrowers must submit a written description of the actions that will be taken, including timeframes for restoring compliance with the current management plan and Agency rules and regulations.

E. Continued Management Discrepancies

If the Agency discovers continued discrepancies between a project's management plan and project operations, the Agency retains the authority to terminate the current management agreement and require the borrower to install a new management entity acceptable to the Agency.

3.4 THE MANAGEMENT CERTIFICATION

As a condition of Agency approval of the management agent and the management fee, the borrower and the management entity must execute a *Form RD 3560-13, Management Certification*, and submit this to the Agency each time the borrower proposes a management agent and a management agreement is executed. The borrower and the management agent must jointly submit the certification to the Agency to attest that:

- The borrower and management agent agree to operate the housing project in accordance with the management plan;

- The borrower and management entity will comply with Agency requirements and contract obligations, agree that no payments have been made to anyone in return for awarding the management contract to the management agent, and ensure that such payments will not be made in the future;

- The borrower and the management agent will comply with Agency handbooks, notices, and other policy directives that relate to the management of the housing project;

- The management agreement between the borrower and the management entity complies with the requirements described in this chapter;

- The borrower and the management agent will refrain from purchasing goods and services from entities that have identity-of-interest (IOI) relationships with the borrower or the management agent until the IOI relationship has been disclosed to the Agency and not denied by the Agency; and

- The borrower, management agent, and supplier of goods and services agree that all records relating to the housing project are the property of the project, the Agency, and the Agency's representatives.

The management certification also requires that the borrower and the management agent identify any and all IOI relationships that would involve project funds. *Form RD 3560-13* must be submitted to the Agency.

For management agents proposing IOI firms to provide goods and services to Agency properties, a fee schedule of these goods and services must be attached to *Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate*. The Agency must approve the borrower's use of such firms prior to the borrower entering into any contractual relationships that involve Agency funds with such entities.

After the borrower or management agent discloses an IOI relationship in *Form RD 3560-31*, the Agency will:

- Require the borrower, management entity, and supplier of goods and services to provide documentation proving that use of IOI firms is in the best interest of the housing project;

- Require that all suppliers of goods and services agree to certify in writing to the Agency that the individual or organization proposed is qualified and licensed, if appropriate;

- Require the borrower, management entity, and supplier of goods and services to agree in writing to make available all records relating to the housing project to the Agency or the Agency's representative; and

- Deny the use of an IOI firm when the Agency determines that using the firm is not in the best interest of the Federal Government or the tenants.

A. The Role of the Management Agreement

While the management certification replaces the need for the Agency to approve the management agreement, it does not eliminate the need for the borrower and the agent to execute a management agreement. By executing the management certification, the borrower and the agent are assuring Agency staff that an acceptable agreement has been executed. Agency staff may review this agreement during the supervisory visit. Borrowers operating owner-managed projects are not required to execute a management agreement.

B. Agency Approval of the Management Certification

A certification must be submitted for Agency approval prior to the initial approval of the management agent. Subsequent certifications must be submitted for Agency approval when any of the following occurs:

- An increase in the management fee is requested, if the increased management fee is not in accordance with Attachment 3-F;
- A new management agent is proposed; or
- A management agreement expires and a new agreement is executed or renewed.

The borrower must submit a new certification to the Agency for approval at least 45 days prior to the date of the proposed change. The Agency will return the approved or denied certification within 60 days of receipt.

3.5 SELF-EVALUATIONS AND TRANSITION PLANS

On June 11, 1982, USDA issued 7 CFR 15b, which required all borrowers to conduct self-evaluations of their facilities, policies and procedures for compliance with Section 504 of the Rehabilitation Act of 1973 and the Uniform Federal Accessibility Standards (UFAS), within 1 year of the USDA regulation. Information related to these compliance issues as they affect Section 514, 515, 516, and 521 housing may be found in answers to frequently asked questions in **Appendix 5**. In the event that structural changes were necessary, recipients were required to develop transition plans that set forth the steps necessary to complete such changes.

Borrowers may become liable for fines and penalties imposed by enforcement agencies, loss of tax credits, or legal actions if found in noncompliance with civil rights laws. The Agency does not impose these fines and penalties, but will follow regulatory, supervisory, servicing procedures and loan eligibility requirements when noncompliance is found.

A. Borrowers Required to Conduct Self-Evaluations and Develop Transition Plans

The following borrowers must conduct self-evaluations and develop transition plans:

- Borrowers of projects ready for occupancy on or before June 10, 1982.
- Borrowers of projects ready for occupancy after June 10, 1982, who have been found in noncompliance with Civil Rights law (as a remedial action).
- Borrowers who have had complaints filed against them, when the Agency determines it necessary.
- Borrowers transferring ownership.
- Borrowers of projects receiving rehabilitation or equity loans, when the Agency determines it necessary.

- Borrowers receiving loans for new construction after August 20, 2002. The Agency will review the self-evaluation and any transition plan during the preoccupancy conference.

- All state and local government borrower entities. The Department of Justice issued a regulation on July 26, 1991, which requires all state and local governments to conduct self-evaluations, unless they had already done so to meet the requirements of Section 504.

- Borrowers receiving loans after January 1, 2001, if a self-evaluation has not been conducted within the last 3 years.

B. Standards Borrowers Must Meet

Regardless of when a project was ready for occupancy, all borrowers are required to have policies and practices that do not discriminate against persons with disabilities. The architectural accessibility standards borrowers must meet will depend on when the project was ready for occupancy and what modifications are planned. In addition, many state and local governments have their own accessibility standards that must be met. The Agency does not have the authority to waive any accessibility requirements.

C. Self-Evaluation and Transition Plan Requirements

1. Self-Evaluations

In accordance with 7 CFR 15b, self-evaluations must:

- With the assistance of interested persons, including persons with disabilities or organizations representing disabled persons, evaluate their current policies and practices and the effects thereof;

- After consultation with interested persons, including disabled persons or organizations representing disabled persons, modify any policies and practices that do not meet the requirements of this part;

- After consultation with interested persons, including disabled persons or organizations representing disabled persons, take appropriate remedial steps to eliminate the effects of any discrimination that resulted from adherence to these policies and practices that do not meet the requirements of this part; and

- Maintain a record of the self-evaluation for at least 3 years. The record must be made available for public inspection and be provided to the Agency upon request. The self-evaluation record must contain:

  ◊ A list of the interested persons consulted;

  ◊ A description of areas examined and any problems identified; and

◊ A description of any modifications made and any remedial steps taken.

2. Transition Plans

At a minimum, transition plans must:

- Identify physical obstacles in the borrower's facilities that limit the accessibility of their property to disabled persons;
- Describe in detail the methods that would be used to make the facilities accessible;
- Specify the schedule for taking the steps necessary to achieve full program accessibility and if the time period of the transition plan is longer than 1 year, identify steps that will be taken during each year of the transition period; and
- Identify the person responsible for implementation of the plan.

When structural changes are necessary, such changes must be made as expeditiously as possible within 3 years.

SECTION 2: APPROVING, REMOVING, AND REVIEWING THE MANAGEMENT AGENT *[7 CFR 3560.102]*

3.6 THE MANAGEMENT AGENT

A. Acceptable Types of Management Entities

Exhibit 3-1 shows the three types of management entities.

Exhibit 3-1

Three Types of Management Entities

A. Borrower/manager
B. IOI management agent
C. Independent fee management agent

In this Handbook, the term "management agent" applies to all three forms of management entities, unless a specific distinction is made because of policy or procedural differences.

1. Borrower/Manager

In the borrower/manager relationship, the borrower and the management agent are the same business entity. This is often referred to as "self-management or owner-managed"." A project is not self-managed if some or all of the same individuals are involved in both the borrower entity and the management agent but the organizations are legally different business entities.

For example, if the borrower is a limited partnership and the general partner of the borrower entity serves as the management agent, the management agent is not a borrower/manager because the management agent and the borrower are different business entities. Instead, the management agent is an identity-of-interest management agent.

2. Identity-of-Interest Management Agent

An IOI relationship exists when an individual or entity that provides goods, management, or other services to the project has a relationship with the project borrower that is such that selection of the management agent and determination of the management fee will not be determined through an arms-length transaction. Exhibit 3-2 further describes this relationship.

Failure to disclose such IOI relationships may subject the borrower, the management agent, and other firms or employees among whom the IOI relationship exists to suspension, debarment, or other remedies available to the Agency.

Exhibit 3-2

Identity-of-Interest Relationships

An IOI relationship exists when:

- The borrower entity, any principal of, or a general partner of the borrower entity; or
- Any officer or director of the borrower entity; or
- Any person who directly or indirectly controls 10 percent or more of the voting rights, or owns 10 percent or more of the borrower entity

is also

- A borrower, general partner, officer, or director of the management agent company or its subcontractor; or
- A person who directly or indirectly controls 10 percent or more of the voting rights, or owns 10 percent or more of the management company or its subcontractor.

As used above, "person" refers to any individual, partnership, corporation, or other business entity. Any borrowership, control, or interest held or possessed by a person's spouse, parent, child, grandchild, or sibling or other relation by blood or marriage is attributed to that person for this determination.

As used above, "subcontractor" refers to any individual or company that contracts with the management agent to provide management services to the project.

3. Independent Fee Management Agent

An independent fee management agent is a management company or individual that has no IOI relationship with the borrower and no financial interest or involvement in the project, other than earning a fee for providing management services.

B. Approval of the Proposed Management Entity

A management entity will be deemed acceptable by the Agency provided that the agent or staff member has a minimum of 2 years of experience and satisfactory performance in directing and overseeing the management of similar Federally assisted multi-family housing. Management services are a lower-tier transaction and subject to debarment and suspension check by the Agency in accordance with 7 CFR 3017 and RD Instruction 1940-M. Management entities found to have been disbarred are not eligible for approval by the Agency.

In addition, the Agency may issue approval to a management agent if the agent's *Form RD 1944-37* shows that a small percentage of the properties it has managed are either in default or have a mortgage delinquency and either one of the following can be documented:

- The default or delinquency was due to circumstances beyond its control; or

- The agent is making satisfactory progress toward improving the problem property's operations.

The Agency reserves the right to deny approval of any proposed management entity that does not meet such requirements. The Agency may issue a denial of a proposed management agent if:

- The agent and/or its staff does not have 2 years of experience successfully managing Section 514, 515, or 516 properties as relevant or other assisted housing;

- If the agent's *Form RD 1944-37,* shows that a substantial percentage of the properties it has managed are either in default or have a mortgage delinquency; or

- If the agent's *Form RD 1944-37,* shows that a small percentage of the properties it has managed are either in default or have a mortgage delinquency and the management agent is not addressing the property's or properties' deficiencies.

To request approval of the management entity, the borrower/agent must submit the following information to the project's Field Office at least 45 days before the date the borrower wishes the new agent to assume responsibility. In the case of emergency replacements of management agents, the borrower/agent must submit the information needed for the Agency to review and approve the new management agent as soon as the new agent is identified. Borrowers must submit the following documents when requesting Agency approval of an agent:

- **Management plan.** The management plan establishes the systems and procedures that will be employed onsite to ensure that project operations comply with Agency requirements. *Form RD 1944-37,* must be included as an attachment to the management plan.

- **Management certification.** Using *Form RD-3560-13*, the borrower and management agent together certify that they will comply with Agency requirements and contract obligations and will execute an acceptable management agent agreement, and that no payments have been made to the borrower in return for awarding the management contract to the agent nor will such payments be made in the future.

- **RD Forms 3560-30 Certification of No Identity of Interest or 3560-31 Disclosure and Qualification of Identity of Interest, as applicable**.

- **Additional information required by the Field Office.** Agency staff may require borrowers to submit additional information to clarify materials already submitted. Materials requested may address:

  ◊ Determining the management agent's acceptability;

  ◊ Monitoring the agent's compliance with Agency requirements;

◊ Resolving project operating problems; and

◊ Justification of contractual relationship with IOI or third-party contractors.

The Agency must review all items listed above within 30 days of receipt. The review will consist of the following:

- **Review of Previous Participation Certification.** If the management agent is new to the Agency and manages properties assisted by HUD, local public housing agencies, and State housing finance agencies, the servicing jurisdiction must obtain references from the appropriate jurisdiction on the management agent's past performance. For instance, if the management agent has managed HUD properties, then the Agency is required to contact the appropriate HUD Field Office and obtain a reference or request that HUD provide a copy of the most recent *Form RD 1944-37*.

- **Review of the proposed management plan.** This review ensures compliance with the Agency's submission requirements and determines if the proposed systems and procedures:

  ◊ Are in compliance with Agency requirements;

  ◊ Can reasonably be implemented at the project; and

  ◊ Are reasonably tailored to the particulars of the project.

Within 30 days of receipt of information from the borrower/management agent, the Agency will inform the borrower of its decision in writing.

If the Agency grants approval, the borrower may enter into a contract with the management agent to begin no sooner than 45 days from the date of submission of the approval package.

If the Agency issues a denial, the borrower will be provided with appeal rights. The borrower may not enter into a formal agreement with the management agent being reviewed by the Agency. If a borrower enters into an agreement with a management agent or begins to self-manage prior to receiving Agency approval, the Agency will place the borrower in nonmonetary default status. The Agency will ask the borrower, if not in a self-management arrangement, to immediately terminate the contract with the management entity. Under emergency circumstances, with Agency consent, the borrower may enter into a temporary agreement with a different management entity for 30 days.

C. Use of Management Entities without Agency Approval

If a borrower enters into an agreement or contract with a management entity that has not been approved by the Agency, the Agency is authorized to immediately terminate the borrower's agreement or contract with that entity. This action is not appealable.

3.7 REMOVAL OF A MANAGEMENT AGENT

As permitted in the management certification, the Agency reserves the right to remove the management agent for lack of performance or deliberate fraud against the project or the Government. Some specific reasons for requiring removal of a management agent are listed in Exhibit 3-3. Other reasons also may apply.

Exhibit 3-3
Specific Reasons for Requiring Removal of a Management Agent

A. Lack of performance:

- Failure to adhere to the provisions of the management certification;
- Repeated failure to adhere to the management plan; and
- Noncompliance with applicable state and local laws.

B. Fraud against the project and/or Government:

- Misappropriation of project funds;
- Paying kickbacks to contractors, subcontractors, or service providers; and
- Deliberately requesting more Rental Assistance than that to which the project is entitled.

If the Agency determines that the management agent is in violation of the management certification, the Agency will:

- Send a servicing letter, *Handbook Letter 301 (3560), Servicing Letter #1*, notifying the borrower of the violation;

- State that the management agent must prove that there was no violation or that there were mitigating circumstances, and the borrower must respond to the Agency within 30 days of the receipt of the servicing letter;

- If the borrower does not respond satisfactory within the prescribed time period with either (1) documentation that the violation did not take place, or (2) a plan to address the violation within a certain period of time that is acceptable to the Agency, the Agency will send the borrower a second servicing letter, *Handbook Letter 302 (3560), Servicing Letter #2*; and

- If the borrower does not respond within the prescribed time period in the second servicing letter, the Agency will send a third servicing letter, *Handbook Letter 303 (3560), Servicing Letter #3* indicating that the management certification will be terminated by a certain date. As of that date, no management fees may be paid to the agent from project funds. If the information reveals that management fees were paid to the agent subsequent to termination of the management certification, the borrower will be required to reimburse the funds to the project operating account.

If the borrower is required by the Agency to remove the management agent, they must do so under the timeframe required by the Agency or file an official appeal, as described in Chapter 1, stating why they believe the agent should not be removed. Failure on the part of the borrower to comply with Agency demands to remove the agent may result in acceleration of the loan and debarment from further participation in Agency programs.

SECTION 3: SETTING THE MANAGEMENT FEE *[7 CFR 3560.102]*

3.8 THE MANAGEMENT FEE

A. The Purpose of the Management Fee

The purpose of the management fee, which is an allowable expense paid from the housing project's general operating account, is to compensate the management agent for services provided to the project. These services are described in **Attachment 3-D**.

B. Types of Management Fees

There are two major types of fees that, when added together, make up the overall management fee for a project:

- Occupied unit fee; and
- Add-on fees.

The occupied unit fee is the largest component of the management fee. It must be quoted and calculated as a per-unit, per-month (pupm) fee for revenue producing units occupied during a given month. This requirement gives the agent an incentive to maximize occupancy.

Add-on fees are quoted as dollar-per-unit amounts because they relate to project conditions that are not a function of project occupancy.

1. Occupied Unit Fee

In order to establish the base fee, States survey and collect management fee data from other assisted housing sources such as local Housing and Urban Development field offices, State Housing Finance Agencies, Housing Authorities, local housing organizations, and nonprofits. To provide consistency, the States are divided into Regions. In order to accommodate the travel requirements for servicing properties within Alaska and Hawaii, a separate region has been created. Each Region identifies a Coordinating State. This State is responsible for the coordination between the States, the dissemination of information to the States and all submissions to the National Office. The Regions are identified as follows:

REGION I: CT, MA, ME, NH, RI, VT

REGION II: NJ, NY

REGION III: DE, MD, PA, VA, WV

REGION IV: AL, FL, GA, KY, MS, NC, PR, SC, TN, VI

REGION V: IL, IN, MI, MN, OH, WI

REGION VI: AR, LA, NM, OK, TX

REGION VII: IA, KS, MO, NE

REGION VIII: CO, MT, ND, SD, UT, WY

REGION IX: AZ, CA, NV **REGION X:** ID, OR, WA

REGION XI: AK, HI

Each Region as defined above collaborates to derive a median pupm fee known as the Regional Median. A range of $5 higher or lower than the Regional Median is the Regional Range. Ex: Regional Median = $25 pupm; Regional Range = $20 pupm to $30 pupm.

Each State derives a single pupm fee within the established Median Range (of the region) to be used by all management companies within that State. Please note that the Regional Median fees are to assist States in determining a maximum pupm fee in their State. Borrowers and management agents may negotiate fees less than the State pupm fee.

> For example: The Regional Median is $30 pupm. The Regional Range is $25 to $35 pupm. The State has derived a fee of $33 pupm. The borrower and the management agent have agreed on a fee of $29 pupm. The agreed upon fee is acceptable.

Each Region provides information about the organizations within its States, documents contacts and provides a description of the fee structure used by the source organizations. The description should include the amount of the management fee, how the management fee was established, and a 'bundle of services' comparability synopsis.

The State Directors within the Region review the State documentation and provide a signature of approval for the State pupm fee. The Coordinating State submits the completed worksheets and any additional information to the National Office.

If States within a Region are unable to negotiate a Regional Median, the National Office will determine the Regional Median. If a single state within a Region is unable to negotiate with the other states in the Region, the National Office will determine the state maximum fee for that state.

2. Add-On Fees

Add-on fees are a flat pupm fee paid to agents managing projects with long-term project characteristics and conditions that require additional management effort beyond the activities covered by the standard management fee. The add-on fee is applicable to all revenue producing units regardless of occupancy status. See exhibit 3-4 for types of add-on fees.

- The National Office has established a standard list of add-on fees that is applicable to all states.
- Exhibit 3-4 project characteristics or conditions that warrant the use of add-on fees.

Add-on fees should not cover project characteristics or conditions that are already covered in the base fee. Agents may not take add-on fees for management of properties with workout agreements except under limited circumstances, and solely at the Agency's discretion. If it is demonstrated that conditions at the property are beyond the management agent's control, the Agency may agree to allow the management agent to take add-ons fees for the circumstances listed in Exhibit 3-4.

Exhibit 3-4

National Office Approved Add-On Fees

Type of Add-on Fees	PUPM
Management of properties with 15 units or less	$2.00
One project that has buildings located on different noncontiguous parcels of land (i.e. across town or in another town).	$2.00
Management of properties in a *remote location	$2.00
Troubled properties with workout plans **and** new management only.	$2.00

* "Remote location" is defined as areas that are sparsely populated with no services and few contractors.

The established fees available on Attachment 3-F must be reflected in the proposed budgets for the fiscal year 2009 (for borrowers with operating budgets beginning January 1st). Borrowers are required to convert to the new fees upon expiration of the current Management Agreement or its renewal.

The Agency's decision regarding the amount of management fees set by the region and the state is unappealable.

C. Services Paid from the Management Fee

The purpose of the management fee is to compensate the Agent for providing oversight to the project including:

- Overseeing compliance with National, state, and local laws and regulations;
- Establishing strong project management policies and procedures; and
- Overseeing the implementation laws, regulations, policies, and procedures through the supervision of onsite staff.

A breakdown of items that are to be paid from the management fee can be found in **Attachment 3-D.**

D. Services Paid from Project Income

In general, project income is used to pay for project-related items. Examples include the salary, benefits, and office expenses of onsite office staff and maintenance expenses for the property and costs for processing project-specific transactions (e.g., tenant certifications). A specific breakdown of items that are to be paid from project income as opposed to the management fee can be found in **Attachment 3-E**.

The borrower and management agent must obtain materials, supplies, utilities, and services at a reasonable cost and seek the most advantageous terms for the project. The borrower or management agent must credit any rebates, fees, proceeds, or commissions generated by transactions using project funds to the project.

SECTION 4: INSURANCE, BONDING, AND TAXES *[7 CFR 3560.105]*

3.9 OVERVIEW

Insurance protects the asset against loss or damage. Borrowers without adequate insurance coverage are financially responsible for:

- Property damage;
- Losses due to employee dishonesty or error; and
- Personal injuries that occur on the property.

Borrowers are responsible for acquiring and maintaining insurance on all dwellings and buildings that are necessary for the operation of the project in accordance with their loan or grant documents. Insurance must be in place at loan closing and must remain in place until the loan is paid in full. Reevaluation of insurance coverage is necessary when new buildings are constructed or values increase or decrease materially. Any refund or rebate from the insurance company must be credited to the project's account.

The Servicing Office is responsible for counseling the borrower regarding the Agency's insurance requirements. Through MFIS, Loan Servicers will monitor insurance policy expiration and ensure borrower compliance. The Agency will obtain insurance for the secured property if the borrower is unable or unwilling to do so. If a borrower refuses to pay the insurance premium with their own funds or fails to arrange with the agent for subsequent payment by premium note or otherwise, the Agency will pay the amount of the insurance premium and charge the premium payment amount and all costs associated with procurement of the required insurance to the borrower's Agency account. The Agency considers a borrower's failure to maintain adequate insurance coverage or to pay taxes as nonmonetary default. Borrowers who fail to furnish property and hazard insurance coverage of any kind are responsible for the debt in the event of loss.

3.10 PROPERTY INSURANCE

Property or "all-risk" insurance protects the physical asset against loss due to damage. Types of property insurance are described below.

A. Hazard Insurance

1. Loss or Damage Covered

Hazard insurance protects the property against fire and weather-related damage, as well as damage from civil commotion, aircraft, or other vehicles. These policies may also be known as fire and extended coverage, homeowners, all physical loss, or broad form policies.

2. Coverage Requirements

The minimum property insurance coverage per building is 100 percent of the insurable value as reflected in the appraisal report, as referenced in Chapter 7 of HB-1-3560. If no appraisal report is required, the Agency will perform the necessary evaluations and determine and document the minimum insurance coverage requirements in the file.

3. Deductible

If a property's insurance policy has a deductible, the deductible must be accounted for in the reserve account, unless the deductible does not exceed:

- $1,000 on any project with an insurable value under $200,000; or
- One-half of 1 percent of the insurable value, up to $10,000 on a project with an insurable value over $200,000.

B. Flood Insurance

1. Loss or Damage Covered

Flood insurance protects the property against flooding caused by natural disasters such as hurricanes. This coverage is required only for those properties located in areas identified as flood hazard areas.

2. Coverage Requirements

Flood insurance is required for any property located in a Special Flood Hazard Area (SFHA), as identified by the Federal Emergency Management Agency (FEMA). *FEMA Form 81-93, Standard Flood Hazard Determination* is used to determine if a property is in a SFHA and whether flood insurance is available under FEMA's National Flood Insurance Program. If the property is in a SFHA, the Agency will notify the borrower using *Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance*. The borrower must sign and return *Form RD 3550-6* prior to loan closing. If the borrower cannot secure flood insurance through FEMA's National Flood Insurance Program in a SFHA, the property is not eligible for Federal financial assistance.

3. Deductible

The Agency allows a maximum deductible of $5,000 per building.

C. Earthquake Insurance

1. Loss or Damage Covered

Earthquake insurance covers property losses in the event of an earthquake. Earthquake coverage is recommended in areas where earthquakes are prevalent; however, it is very expensive and generally has a high deductible.

2. Coverage Requirements

Although the Agency does not specifically require a project to be covered by earthquake insurance, it recommends a Probable Maximum Loss (PML) seismic study for all projects located in certain regions of the country where earthquakes are prevalent. The coverage amount should be for 100 percent of the replacement cost of the project.

3. Deductible

In the event that the borrower obtains earthquake coverage, the Agency is to be named as a loss payee. The deductible should be no more than 10 percent of the coverage amount.

D. Windstorm Insurance

1. Required Coverage

The windstorm policy should include extended coverage for rental loss for at least 12 months, except for coverage provided by State insurance programs.

2. Deductible

When windstorm coverage is excluded from the “all risk” policy, the deductible must not exceed 5 percent of the total insured value.

E. Builder’s Risk Insurance

Builder’s risk insurance protects the property against loss or damage during construction or reconstruction after an insured loss.

F. Elevator, Boiler, and Machinery Insurance

1. Loss or Damage Covered

Elevator, boiler, and machinery coverage may be required for any property that operates elevators, steam boilers, turbines, engines, or other pressure vessels.

2. Coverage Requirements

The Agency requires boiler and machinery insurance in any property that has centralized Heating, Ventilating, and Air-Conditioning (HVAC) equipment in operation.

G. Sinkhole Insurance or Mine Subsidence Insurance

1. Loss or Damage Covered

Sinkhole insurance or mine subsidence insurance is recommended for projects located in areas prone to these geological phenomena.

2. Coverage Requirements

The amount of coverage that the Agency recommends for properties located in areas prone to these geological phenomena is 100 percent of the replacement cost of the structure affected.

3. Deductible

The deductible for sinkhole insurance or mine subsidence insurance should be similar to what would be required for earthquake insurance.

H. Business Income or Rent Loss Insurance

1. Loss or Damage Covered

Business income or rent loss coverage provides coverage for the loss of rental income incurred due to a property loss during a 12-month period.

2. Coverage Requirements

The Agency does not require but recommends that the project be insured against loss of business income or rent in the event of a property loss that causes one or more units to be uninhabitable for a period of time. Business income coverage may be obtained in one of two forms:

- Actual loss sustained; or
- A fixed amount equal to the annualized amount of monthly gross potential rents.

I. Acceptable Exclusions

Acceptable exclusions from “all risk” insurance policies include:

- War or military action;
- Nuclear hazard;
- Volcanic eruptions;
- Fraudulent or dishonest acts committed by the insured;

Dispersal, release, or escape of contaminants or pollution (biological or chemical agents); and

- Terrorism.

J. Property Insurance Exemptions

Property insurance is not required if:

- The building is in such a state of disrepair that the cost of insurance would be prohibitive;
- The building has a depreciated replacement value of $2,500 or less

K. Property Insurance Policy Requirements

The project's property insurance policy must include the following:

- **Name and location.** The policy should contain the names of the borrowers who are owners of the property being insured. The exact location of the property should be described in the policy.
- **Loss or damage covered.** The policy must indicate that the buildings are insured against loss or damage by fire, smoke, lightning, windstorms, hail, earthquake, explosion, riot, civil commotion, aircraft, and vehicles.
- **Effective date of insurance.** If there are insurable buildings located on the property, the policy's effective date will be on or before loan closing or assumption, or before the credit sale is closed, so that the policy will properly insure the borrower and the mortgagees. When new buildings are erected or major improvements made to existing buildings, such insurance will be made effective as of the date materials are delivered to the property. The Agency will not advance loan funds for labor or materials until the borrower has furnished adequate insurance to protect the interest of the Agency.
- **Term.** The borrower must furnish insurance for a term of at least 1 year, with evidence that a full year's premium is paid. If the policy is the type that imposes an assessment only after a loss has occurred, the borrower must provide documentation from the insurance company that no assessment is owed. If the insurance policy is automatically renewable, the renewal clause must meet Agency requirements.
- **Loss payee.** The Agency must be named loss copayee on all properties where it holds first lien position, which means if there is a damage or loss, the insurance draft will be made payable to the Agency. Further, the Agency must be named as an additional insured if its lien position is other than first.

- **Mortgage clause.** The standard mortgage clause adopted by the State or the Agency *Form RD 426-2, "Property Insurance Mortgage Clause (Without Contribution)"* must be attached to or printed in the insurance policy. Whenever a new mortgage clause highlighting the Agency's interest is issued after the policy has been in force, the new mortgage clause must be signed by an authorized agent or officer of the company that issued the policy.

  The mortgage clause is not required if:

  ◊ An authorized official of an insurance company provides a statement that all insurance policies the company issues in the state, and in which Rural Development has a mortgage interest, incorporate all of the provisions of *Form RD 426-2*. This statement may be accepted in lieu of attaching the form to each policy. If such a blanket letter is used, Rural Development must be named in the loss payable clause and a state instruction will be issued authorizing the use of this method after prior approval is obtained from the Agency.

  ◊ For all hazard and flood insurance policies the Agency will be named as copayee.

  ◊ For builder's risk policies the borrower must be named as the insured party, and the policy must convert to full coverage when the project is completed.

3.11 FIDELITY COVERAGE

A. Loss or Damage Covered

Fidelity insurance protects the property against loss due to employee dishonesty. The policy will provide coverage on all persons with access to project assets. Fidelity coverage may also be known as Blanket Crime Coverage or Fidelity Bond.

B. Coverage Requirements

The fidelity insurance policy, at a minimum, must include an insuring agreement that covers employee dishonesty. The minimum amount of fidelity coverage will be the amount calculated by multiplying an exposure index by a coverage factor. When the calculated amount is less than $10,000, minimum coverage of $10,000 must be provided. This calculation is made as follows:

- <u>Determine exposure index</u>: Exposure index = 25 percent of the SUM of annual cash receipts (rents, cash subsidy, security deposits and interest, etc.) and cash (cash carryover, reserves, CDs, tax and insurance escrows, etc.). Round to next higher $1,000.

- <u>Determine coverage</u>: Coverage = exposure index X coverage factor taken from the coverage chart shown in Exhibit 3-5. Round to next higher $1,000.

Exhibit 3-5

Fidelity Coverage

Exposure Index	Coverage Factor
$100,000 or less	0.30
$100,000 to $200,000	0.28
$200,000 to $300,000	0.26
$300,000 to $400,000	0.24
$400,000 to $500,000	0.22
$500,000 to $600,000	0.20
$600,000 to $700,000	0.18
$700,000 to $800,000	0.16
$800,000 to $900,000	0.14
$900,000 to $1,000,000	0.12
$1,000,000 or more	0.10

C. Deductible

A deductible is designed to allow flexibility in balancing what the project can prudently pay from its own assets, at a time of loss, against the economy of annual premiums in its annual budget. The deductible levels shown in Exhibit 3-6 will meet Agency requirements. Each year borrowers must review and adjust, if necessary, their fidelity coverage.

Exhibit 3-6

Fidelity Coverage Deductible Levels

Fidelity Coverage	Deductible Level
Under $50,000	$1,000
Up to and including $100,000	$2,500
Up to and including $250,000	$5,000
Up to and including $500,000	$10,000
Up to and including $1,000,000	$15,000

D. Exemptions

Fidelity insurance is not required under the following circumstances:

- When a loan is made to an individual or a general partnership, and that individual or general partner will be responsible for the project's financial activities. Individuals cannot bond against their own actions. For land trusts where the beneficiary is responsible for project management, the beneficiary is treated as an individual.

- For the general partners of a limited partnership, unless one or more of its general partners perform financial acts coming within the scope of the usual duties.

E. Policy Requirements

Fidelity coverage must be documented on a bond form acceptable to the Agency. Fidelity coverage policies must state that the insurance company will provide protection to the insured against the loss of money, securities, and property through any criminal or dishonest acts by any employee acting alone or in collusion with others. The amount of indemnity will not exceed the amount stated in the declaration of coverage.

The portion of the insurance premium to cover project site employees and general partners is an eligible project expense. The premium paid by the management agent is part of the agent's management expense and cannot be claimed as a project expense. When a project site employee is covered under the management agent's fidelity policy, the pro rata portion of the premium covering the employee should be reflected in the management plan.

3.12 ERRORS AND OMISSIONS INSURANCE

Errors and omissions (E&O) coverage protects the borrower against loss resulting from negligence, errors, or omissions committed by those persons covered under the borrower's fidelity insurance policy. Obtaining E&O insurance does not diminish or limit the borrower's documentary obligations and responsibilities.

3.13 LIABILITY INSURANCE

A. Loss or Damage Covered

This coverage insures against any personal injury that might occur in or on the project's common areas, common elements, commercial space, and public areas.

B. Coverage Requirements

The coverage must meet the requirements established below.

1. Commercial General Liability

The insurer's limit of liability per occurrence for personal injury, bodily injury, or property damage under the terms of coverage must be at least $1,000,000. Coverage may also include borrower exposure to risks such as E&O and environmental damage, or protection against discrimination claims.

2. Umbrella Liability Insurance

The Agency recommends, but does not require, the borrower to obtain umbrella liability insurance to provide coverage over and above the $1,000,000 provided for in the commercial general liability policy. The Agency recommends that umbrella liability insurance policies provide coverage as follows:

- For projects with buildings of 1 to 3 stories, $1,000,000;
- For projects with buildings of 4 to 10 stories, $5,000,000; and
- For projects with buildings of 11 to 20 stories, $10,000,000.

3. Commercial Automobile Liability Insurance

The Agency recommends that the borrower purchase commercial automobile liability insurance to cover all automobiles used for business purposes related to the project. The recommended amount of coverage is $1,000,000 per occurrence.

C. Deductible

The Agency allows a deductible not to exceed $5,000 per occurrence.

3.14 WORKERS' COMPENSATION

This insurance coverage, which is also known as employer's liability coverage, is required by the Agency.

3.15 POLICY RENEWALS

When renewing insurance policies, if the best policy the borrower can obtain contains a deductible clause with amounts greater than those stated above, the borrower must submit to the Loan Servicer:

- The insurance policy; and
- An explanation and documentation that more adequate insurance coverage was not available.

3.16 BLANKET POLICIES

Blanket insurance policies for several buildings or properties located on noncontiguous sites are acceptable if the insurer provides proof that the secured property is as fully protected as if a separate policy were issued.

Blanket crime insurance coverage or fidelity bonds are acceptable types of fidelity coverage. At a minimum, a borrower must provide the Agency with an endorsement listing all Agency properties and their locations covered under the policy or bond as evidence of required fidelity insurance. The policy or bond may also include properties or operations other than Agency-financed properties on separate endorsement listings.

Individuals or organizational borrowers must have fidelity coverage when they have employees with access to Multi-Family Housing complex assets. A borrower who uses a

management agent with exclusive access to housing assets must require the agent to have fidelity coverage on all principals and employees with access to the project. If project management reverts to the borrower, the borrower must immediately obtain fidelity coverage.

3.17 AUTHORIZED INSURANCE PROVIDERS

Borrowers are responsible for selecting an insurance provider that meets Agency requirements. The insurance provider must be licensed or authorized to do business in the state or jurisdiction where the project is located. In making the determination that an insurance company is reputable and financially sound, the Agency uses all relevant available information, including financial statements, Best's Insurance Reports, and information from state insurance authorities.

The borrower and management agent are required to disclose any IOI relationships with the insurance company.

3.18 BORROWER FAILURE TO MEET INSURANCE REQUIREMENTS

The Servicing Office is responsible for taking all actions in connection with insurance that are necessary to protect the security interest of the Agency. Any unusual situation that may arise with respect to borrower procuring or maintaining insurance should be referred to the State Director. The State Director may refer questions to the Office of General Counsel (OGC).

A. Unacceptable Insurance Policy

When the borrower submits a policy or binder that does not meet Agency requirements, the Field Office Staff will return the policy/binder to the borrower with a form letter that provides the reasons for the policy's unacceptability and requires an acceptable policy within 30 days of the date of the letter.

If acceptable coverage still is not obtained from an authorized provider and the determination has been made to continue with the borrower, the Loan Servicer will temporarily accept from the borrower the available insurance policy the Agency determines most nearly conforms to established requirements. Whenever adequate insurance becomes available, the State Director will require the borrower to deliver to the Servicing Office an acceptable insurance policy.

B. Expired Policies

When an expired insurance policy is not renewed, the Loan Servicer will require the borrower to provide a new policy. The Agency will be shown in the loss payable clause and in the mortgage clause in the proper order of priority. Insurance coverage on each building usually will be the same as shown on the expired policy if it meets or exceeds Agency requirements. If the coverage shown on the expired policy does not meet Agency requirements, the borrower will obtain the proper coverage. If the insurance agency or broker who issued the expired policy refuses to issue a new policy, the Loan Servicer will have the borrower designate in writing another insurance agency or broker from whom the insurance can be obtained.

C. Force-Placed Insurance

If the borrower does not furnish acceptable insurance within the required timeframe the Loan Servicer will begin the process of procuring the required insurance. The costs of procuring the insurance and the premium amount will be added to the borrower's Agency account.

3.19 PROPERTY DAMAGE OR LOSS

Borrowers must notify the Agency and their insurance company agents of any loss or damage to the insured property.

A. When Loss or Damage is Discovered

Upon being notified of loss or damage, the Loan Servicer will:

- If the Agency is listed as mortgagee in the insurance policy, collect the amount of the loss and may also consent to the borrower using the funds to repair or replace damaged or destroyed property or to apply the loss proceeds to their loan account or to any prior liens that might exist in the order of their priority;

- If the Agency is not listed as mortgagee in the insurance policy, contact the borrower to determine whether they have received the loss proceeds. If the borrower has received the loss proceeds but has not yet paid for improvements to repair or replace the property, or has not received the loss proceeds, the Loan Servicer will:

  ◊ Inform the borrower of their responsibility for repairing or replacing the damaged or destroyed property or for authorized disposition of the loss proceeds; and

  ◊ Notify the insurance company in writing of the Agency's interest in the security property and request that the loss proceeds be made payable jointly to the Agency and the borrower.

B. Loss Drafts

A loss draft is payment from the insurance provider for property loss or damage. Loss drafts for loans secured by a first mortgage, which in the opinion of the Agency represents a satisfactory adjustment of the loss will be endorsed immediately without recourse and deposited in a supervised bank account to be used in repairing or replacing the damaged building, except when:

- The amount of the loss is $5,000 or less and the borrower will use the funds for repairing or replacing an essential building. The loss draft may be endorsed without recourse and given to the borrower upon satisfactory proof that the repairs or replacements have been made.

- The essential buildings are not to be repaired or replaced and other suitable buildings are not to be erected.

- A balance remains after all repairs, replacements, and other authorized disbursements have been made, insurance funds can be applied as follows:
  - ◊ To prior liens;
  - ◊ As an extra payment to the borrower's loan account; or
  - ◊ To the borrower's reserve account.
  - ◊ Make other capital improvements to the property as approved by the Loan Servicer.
- The indebtedness secured by the insured property has been paid in full or the draft is in payment for loss of property on which the Agency has no claim. A loss draft that includes the Agency as a joint payee may be endorsed without recourse and delivered to the borrower.

Loss drafts for a loan that is not secured by an Agency first mortgage will be released by the Agency only if the primary mortgagee agrees to the provisions set forth in the previous part.

3.20 REAL ESTATE TAXES

Borrowers are responsible for paying real estate taxes each year. The annual financial statements must include a certification that the property's real estate taxes have been paid. Failure to pay taxes and assessments by the due date will be considered a nonmonetary default.

When the Agency discovers that a borrower has failed to pay property taxes or local assessments, the Loan Servicer will notify the borrower in writing to pay the property's taxes and that paying taxes are the borrower's responsibility. The notification letter will request proof of payment of taxes within 30 days. If the borrower fails to submit proof of payment, the Loan Servicer will:

- Determine if taxes have been paid;
- Pay delinquent taxes and any penalties;
- Charge the cost of bringing the taxes current to the borrower's Agency account; and
- Require the borrower to establish an account to ensure that funds are available for payment of taxes.

The Loan Servicer will begin servicing actions.

SECTION 5: PROJECT MANAGEMENT FOR LABOR HOUSING

3.21 PROJECT MANAGEMENT AND FEES

A. Off-Farm Labor Housing

Project management for off-farm labor housing will be in accordance with the procedures established in this chapter for the Section 515 program. Borrowers are required to submit a management plan and a management certification, and to receive Agency approval on the proposed management agent and the management fee prior to paying a management fee from project income. For off-farm labor housing operated on a seasonal basis, the management plan must establish specific opening and closing dates.

B. On-Farm Labor Housing

Project management for On-Farm Labor Housing projects should follow the same basic procedures as outlined in this chapter for the Section 515 program with the following exceptions:

- On-Farm Labor Housing borrowers are expected to manage their own properties and should not need to charge a fee for this service; and

- On-Farm Labor Housing borrowers are required to maintain a lease or employment contract with each tenant specifying employment with the borrower as a condition for continued occupancy.

3.22 INSURANCE REQUIREMENTS

A. Off-Farm Labor Housing

Off-farm labor housing must comply with the same insurance requirements as specified for the Section 515 program in this chapter.

B. On-Farm Labor Housing

On-Farm Labor Housing borrowers must ensure that they provide hazard insurance adequate to cover replacement of the property in case of loss. On-Farm Labor Housing borrowers must comply with the same flood insurance requirements as specified earlier in this chapter.

3.23 SPECIAL SERVICING REQUIREMENTS FOR SECTION 514 ON-FARM LABOR HOUSING

A. Background.

Prior to January 17, 1993, owners of on-farm type LH were not allowed to charge rent or utilities to eligible tenants residing in the housing if the requirement that the owner execute a loan agreement had been waived. If there had been no waiver of the loan agreement requirement, owners of on-farm type LH were allowed to charge rent and utilities for the unit.

Effective January 17, 1993, regulations required all owners of section 514 on-farm type LH to sign a loan agreement. By signing this agreement, the owners of on-farm LH reaffirmed their obligation not to charge rent or utilities to eligible tenants. Owners who sign the agreement must obtain the Government's prior approval for charging rent, utilities, refundable deposit charges or cleaning fees. Charges must be reasonable and approved in accordance with the procedure. Borrowers not meeting these requirements will be requested to comply with these requirements. Borrowers unwilling or unable to do so may be subject to the RHS initiating appropriate servicing action to seek compliance.

B. Policy.

Field office employees are to ensure that owners of on-farm type LH financed under section 514 are not charging for rent, utilities, refundable damage deposit charges, or cleaning fees to residents, unless the rent, charges, and fees are approved by authorized officials.

Where violations are evident, the owner will be asked, in writing, to come into compliance. Tenants must receive proper notification and an opportunity to comment on proposed rent changes. Borrowers should arrange to request rent changes during periods when migrant residents can be readily contacted. Making requests during the off farm season when tenants are not occupying the units does not excuse the borrower from the responsibility to make effective notification to tenants. Tenants must also receive notice of any approved charges authorized by the Agency prior to imposing charges. Borrowers imposing unauthorized charges must be notified, in writing by the Agency, that they must roll back rates retroactively to the last authorized level. The borrower must give tenants a rebate or credit for the unauthorized charges.

Borrowers with known violations must be brought into compliance or subjected to servicing actions which may include, but not be limited to, added Agency supervisory visits, inspections, and reviews; acceleration; suspension; debarment; and referral to local, state, or Federal officials for investigation and prosecution of violations of civil or criminal law.

C. Definition of Rent:

For administering the section 514 on-farm program, the term "rent" means any charge made by a landlord to an eligible tenant household for the use and occupancy of the housing and includes utilities (i.e., electricity, heat, water, waste disposal, etc.) or the requirement that the tenant pay the utilities directly to the utility provider.

The term "rent" is also clarified to include any deductions or off-sets made to a tenant's wages for the use of a LH dwelling. Rent does not include bona-fide wage changes or reductions unrelated to retaining rent-free housing benefits. Agency officials should seek to obtain and document the following:

- A meeting with the tenants residing in the labor housing should be convened, preferably without the borrower being in attendance in order to ensure objectivity. Solicit the information set out in the Supervisory Visit On-Farm form in MFIS. Letters to tenants in advance of the visit may also be used to solicit this information.

- If the borrower is unable to provide utility bills, contacting the utility company to determine in whose name the utilities are registered. Compare the information solicited by tenant interviews on utilities paid with the utility company data, where possible.

- A review of the borrower's farm and home plan and other financial records to determine whether the borrower is deriving any income from the farm labor housing units. Compare the information solicited by tenant interviews on rent and utility payments with that disclosed by the borrower.

D. Servicing Actions.

- Normal servicing letter and initial follow-up: If the borrower is not complying with Agency regulations (including improperly charging rent, permitting unlicensed occupancy or occupancy during a period for which the housing was not designed) the borrower should be sent the first servicing letter identifying the compliance deficiencies. The letter should normally be sent within 15 days of identification of the compliance deficiencies. Borrowers should normally be requested to issue a response within 15 days of the date of such a letter. When rent change violations are identified, the extent of the violations should be documented, including an estimate of the amount of the improper charges involved and the documentation relied upon to derive these estimates. Borrowers in violation should be requested to show evidence of any reimbursement or crediting of improper charges to those residents affected. This includes documentation of attempts to contact and reimburse former tenants for unauthorized charges. Where documentation shows former tenants cannot be reached for reimbursement of unauthorized charges, the borrower may remit the unauthorized charges to the Government for processing as a miscellaneous payment for crediting to the Rural Housing Insurance Fund.

  Within 30 days of sending any letter to the borrower citing unapproved rent charges, officials should verify whether the borrower has stopped unapproved charging for the use and occupancy of the housing, and if the borrower has refunded tenants any improper charges previously collected. This may be accomplished by a follow-up visit, written communication to tenants, or other effective means. During any follow-up visit, RHS staff should attempt to meet with the tenants to determine if a borrower's improper practice of charging for the use of the housing has ceased. The meeting between RHS staff and the tenants should not be in the presence of the borrower.

- Workout plan to achieve compliance: When a workout plan is being considered to bring a borrower into compliance with Agency regulations. Borrowers that are not in compliance may be eligible for a supplementary payment agreement calling for less than a full loan installment for use in refunding improper charges to residents or former residents. Upon the end of such workout arrangements, including deferred or reduced debt service payments, reamortization of the account should be considered.

Upon compliance with the rent change approval by Agency servicing officials, the borrower may consider waiving the authorized collections and credit residents for payment of the approved charges until such time as the improperly assessed charges are fully offset. Such arrangements should normally not exceed 2 years. Borrowers may not reduce resident wages to finance any reductions in shelter cost charges.

If the housing is not suitable for year-round occupancy, a rent charge approved by RHS may only be assessed for the period of occupancy for which the housing is suitable. The housing may not be occupied and no rent may be charged for the period for which the housing is not suitable for occupancy. If the borrower wishes to make the housing suitable for year-round occupancy, RHS may approve any rent change request for the entire year only after the borrower makes the necessary modifications and obtains all necessary permits and licenses to operate the housing on a year-round basis.

- Secondary request letters: Borrowers failing to respond to letters requesting compliance with Agency regulations, or failing to arrange a meeting to resolve compliance concerns, or failing to arrange to develop an acceptable workout plan, must be notified of the Agency's continued concerns and requested to comply. Borrowers will be advised that the servicing options available to resolve compliance concerns.

- Last notice to avoid more serious servicing actions: Borrowers who continue to be in non-compliance will be requested to comply with Agency regulations and requirements or face the prospects of adverse servicing actions. The timeframe for reply to such a letter should normally be 15 days of the date of such letter. Field office servicing officials will forward a problem case report for borrowers in violation of Agency requirements to the State Director along with recommended servicing actions. The time frame for this action should normally be within 30 days of concluding that efforts to achieve compliance have been unsuccessful.

- Processing problem case reports: The State Director should take appropriate action on problem case reports and request any needed guidance or action from other Governmental officials when warranted. This may include seeking to initiate foreclosure, seeking appointment of a receiver, or to initiate other appropriate legal remedies to enforce compliance. This may also include initiating a request for an audit or investigation from the Office of Inspector General (OIG) in accordance with the provisions of 7 CFR 2012, subpart A or 2012, subpart B.

E. Documentation accompanying problem case reports and required action:

If the borrower has not complied with the requirements set-out in earlier servicing attempts, a complete report of the initial visit and follow-up action should accompany any problem case report forwarded to the State Director for further action.

If, after sending appropriate servicing notices and the borrower does not stop cha HB-2-3560 unauthorized rents and does not provide refunds or credits of any improperly cha to tenants, a problem case report is to be prepared and forwarded to the State Director. State Directors, with the assistance of the Office of the General Counsel, should take appropriate actions to enforce the owner's agreement not to charge rent and to refund or credit any improperly charged rent. Borrowers, who are not able or willing to comply, or enter into an acceptable workout plan to achieve compliance, should:

- Consider initiating acceleration of the account.

- Be considered for a suspension or debarment in accordance with the provisions of 7 CFR 3560, Subpart M.

F. Compliance concerns warranting attention and corrective action:

- Shelter cost changes: If shelter cost changes warrant correction, such as the reimbursement of inappropriate charges to residents through rebates or credits. Borrowers must make efforts to contact and rebate unauthorized charges to former residents. Should the borrower be unable to rebate or credit improper shelter cost charges to affected residents because they cannot be located, the improper charges should be forwarded for processing as a miscellaneous payment for crediting to the revolving fund. Borrowers should not receive indirect benefit from such improper actions such as having any improper collections "credited" to the Government for application as a voluntary additional payment on loans owed the Government. Alteration of *Form 3560-8*, to reflect that rents are being charged, does not constitute appropriate evidence of rent change approval.

- Tenant Notification: If tenant notifications are not supported, a rent change violation is apparent. Corrective action such as reimbursement or credits should be taken.

- Utility allowance documentation: Corrective action should include gathering the required information prior to any approval actions.

- Loan agreement: Corrective action should include a written demand to execute the agreement. Failure to comply with such request warrants forwarding a problem case report to the State Director. This type of non-compliance may require more aggressive servicing actions including additional supervisory visits. Failure to execute the loan agreement may be a sign that other compliance deficiencies exist. Scheduling a supervisory visit as soon as possible but usually not later than 3 months after the failure is warranted to verify whether other compliance deficiencies exist.

- Record keeping and reports: Borrowers are expected to keep appropriate records and reports. This includes the following:

  ◊ Financial records. When residents are not charged for residing in the housing unit, *Form 3560-7A* should be provided for the annual reporting requirements. When residents are charged for residing in the housing unit, adequate financial disclosure is required. Budget reviews should be evaluated to ensure the labor housing is operated in a nonprofit manner (i.e., cash LH expenses for operations, loan installments, taxes, insurance, and upkeep are less than or equal to cash receipts from LH revenue from authorized rents, utilities, security deposits and fees).

  ◊ Documents needed to verify eligibility to reside in labor housing dwelling units. Where rent is being charged, a copy of *Form RD 3560-8, "Tenant Certification"* is appropriate. This documentation should show that a substantial portion of income is derived from farm labor or is considered so earned if the housing was initially provided on a non-rental basis as part of employment compensation for farm labor.

  ◊ Documents showing compliance that tenants are being charged for rent, utilities, refundable security deposits, or cleaning fees. This includes evidence of tenant notification and reporting disclosure requirements, and current utility allowance documentation if residents are being charged for utilities.

- ◊ Evidence that taxes and insurance are paid.
- ◊ Evidence that the property is decent, safe, sanitary, and free from health and safety hazards.
- ◊ Evidence of a management plan, when appropriate.

G. LH Compliance Concerns Detected After Promissory Notes are Paid in Full:

Compliance concerns uncovered after payment in full may warrant servicing letters to borrowers. This is especially appropriate under circumstances where unapproved shelter cost charges are detected. However, when such evidence is over 6 years from the date the borrower's account matured, no notification is required. Where a serious violation is discovered, the Agency may consider taking appropriate actions even though the account matured. The guidance of OGC may be sought in determining what corrective measures can be brought to bear under such circumstances. Such actions may include referral to OIG recommending initiation of an audit or investigation and suspension or debarment from participation in Federal programs under the provisions of 7 CFR 3560, Subpart M.

ATTACHMENT 3-A

MANAGEMENT PLAN REQUIREMENTS

1. The role and responsibility of the owner and the relationship and delegations of authority to the management agent. A management agreement must be provided where a management agent is to be used. If there is no management agent, the management plan should supply the equivalent information concerning the management staff assigned to day-to-day operation of the project even when the owner provides direct management.

   a) Describe and fully justify any identity of interest as described in 7 CFR 3560.

   b) Identify the supervisory relationships, and to whom the incumbent of the position responsible for the day-to-day operation of the project is accountable.

   c) Describe the conditions when the management agent must consult the owner before taking any action.

   d) Identify the person or position in the owner's organization that is the key contact for the management agent.

   e) Describe the type of decisions to be made by this contact person.

   f) Describe the fundamental responsibilities and duties of the owner and the managing agent. Identify any areas of overlap and describe how the overlap will be handled.

   g) Describe any pro rata divisions of singularly incurred operating expense that is common to the management agent and the owner (project) (i.e., fidelity coverage that may be divided between both).

2. Personnel policy and staffing arrangements.

   a) Describe hiring practices of management and their conformance with equal employment opportunity requirements.

   b) Include a staffing plan for the project.

   c) Describe the lines of authority, responsibility, and accountability (internal controls) within the management entity.

   d) Describe the standards and plans for training and familiarizing employees with their job related responsibilities and applicable Rural Development program requirements. Describe how such training will generally be achieved.

3. Plans and procedures for marketing units, achieving and maintaining full occupancy, and meeting *HUD Form 935.2, "Affirmative Fair Housing Marketing Plan,"* requirements.

a) Describe how affirmative marketing practices will be used. Describe the outreach and marketing efforts that will be used to reach those low-income and minority persons who are least likely to apply for such housing without special outreach efforts.

b) Describe the methods that will be used to achieve and maintain the highest possible level of occupancy. When applicable, indicate any additional compensation or incentives that may be allowed management agents for early initial rent-up. (If this area is not covered in the management plan, it will not be allowed at a later date.)

c) Describe how the units will be advertised. Indicate minimum levels planned regardless of occupancy levels.

d) Describe the appropriate communication system, auxiliary aids, or other assistance that will be used to ensure effective communication with applicants, tenants or members, and members of the public that have sight or hearing impairments.

e) Describe the kinds of reasonable accommodation the project can readily provide such as changing water faucets, kitchen equipment, doorknobs, assigning handicap parking spaces, etc.

f) Describe the process management will follow in reviewing and determining whether structural modification of an apartment unit is practical and feasible to reasonably accommodate a tenant or household member who has a disability.

g) Provide a sample waiting list.

h) Attach copies of sample forms that will be used to record unit condition, and indicate who will receive copies of the inspection forms.

i) Describe any orientation services to be provided tenants or members to acquaint them with the project and care of the units. Indicate what printed project information will be given to applicants.

j) Identify the person or staff position responsible for determining tenant or member eligibility and their location on the waiting list.

k) In projects receiving tax credits, explain if special waiting lists will be required when eligible tenants with incomes higher than tax credit limits will be considered for occupancy and how this waiting list will be maintained.

4. Procedures for determining eligibility and for certifying and recertifying incomes.

a) Describe how applications and other records relevant to this function will be kept. If application fees are used, describe them.

b) Describe the level of knowledge, skill, and ability that management official(s) will be expected to possess BEFORE assuming rental related duties such as application processing, eligibility determination, selection, unit assignment, certification, recertification, rent or occupancy charge collection, and record keeping. This discussion should mention training and testing to be provided or obtained to achieve and maintain the level expected.

5. Leasing and occupancy policies.

a) Describe the occupancy standards for the project. (This could be shown as an annex to the management plan.)

b) Describe the project admissions and leasing/occupancy policies and procedures, and criteria for selecting tenants/members for occupancy. (This could be shown as an annex to the management plan.)

c) Describe the level of knowledge, skill, and ability that management official(s) will be expected to understand and apply regarding project lease provisions and prohibitions, occupancy standards, and admissions policies.

d) Describe special procedures that will be used where the marketing area includes non-English speaking or reading persons to assure that such persons will understand leases or occupancy agreements and established rules.

6. Rent and occupancy charge collection policies and procedures.

a) Describe the project rent/occupancy charge collection policy and procedure, covering such matters as where the collection point is, which staff position handles the collection, provisions for collection after normal office hours, recording, and safeguarding of collections.

b) Describe the project security deposit/ membership fee policy and procedure covering matters similar to the preceding item. Include discussion on handling of any interest earned on such deposits.

7. Procedures for requesting and implementing a rent or occupancy charge change.

a) Describe the process to be followed for preparation and request of a change of rents/occupancy charges and/or utility allowances, and to notify tenants of such change, to meet Rural Development requirements.

b) Identify which staff position or person will process change requests.

c) Describe when such change requests will normally be made in terms of economic need and timing within a fiscal year of operation.

8. Plans and procedures for carrying out an effective maintenance, repair, and replacement program.

a) Describe the project objective and general plan for preventive maintenance.

b) Describe where the project's as-built plans and specifications will be located and identify the staff position responsible for updating it as modifications occur.

c) Describe the general maintenance procedures and schedules or cycles to: (this list could be attached as an addendum)

(1) Check and service appliances and mechanical equipment.

(2) Perform safety checks of smoke/fire alarms, fire extinguishers, outside lighting, and ice removal, etc.

(3) Inspect and perform maintenance and redecoration incident to tenant/member move-out and move-in.

(4) Perform major interior and exterior painting and redecorating.

(5) Perform major repairs and grounds maintenance.

(6) Remove garbage and trash.

(7) Perform common areas clean up (parking lot, entryways, hallways, community room, etc.)

d) Describe the project policy and procedure for tenants/members to prepare and submit maintenance requests.

e) Describe the general timing for handling purchase orders and payments.

f) Describe the project policy for budgeting for and/or requesting use of reserve funds for funding major maintenance or replacement items.

g) In migrant or seasonally occupied labor housing (LH), describe the above items in terms of season opening and closing dates.

9. Plans and procedures for providing supplemental services.

a) Describe the types of supplemental services such as laundry and vending machines that will be provided to benefit occupants.

b) Explain whether this equipment will be owned and operated by the owner or a consignee (vendor).

c) Describe the safekeeping and recording practices (internal control) of any cash collections from use of the equipment.

d) Describe who will be responsible for maintaining the equipment and stocking any vending machines.

e) When a consignee will operate the equipment, describe the general terms of the consignment contract.

10. Plans for accounting, record keeping, and meeting Rural Development reporting requirements.

a) Briefly describe the type of project accounting methods (i.e., cash or accrual) and records that will be used, how will they be maintained, and which staff position will prepare and maintain them.

b) Describe how interest earned on project reserve funds will be prorated and accounted "separately" if such funds are deposited jointly with funds of another project owned by the same borrower.

c) Describe whether the project bookkeeping chart of accounts and bank accounts is compatible with *Form RD 3560-7, "Multiple Family Housing Project Budget,"* requirements, and if not, what adjustments will be made when reporting actuals on the form.

d) Identify which staff member or position will be responsible for the preparation and submission of the quarterly and annual reports required by Rural Development.

e) Provide assurance or explanation that the person or firm who will perform and prepare the annual audit, or verification of review, is not associated with the project, other than to perform the audit or review.

f) Discuss the proposed tenant or member record maintenance system including retention of records and identify which person/position will handle and maintain the records.

g) Identify where records subject to Rural Development review will be kept and which person/position Rural Development will contact to review the records.

11. Energy conservation measures and practices.

a) Describe the plan to inform and encourage tenants/members in use of energy conservation practices they can use in their unit to save utility expense (and thus minimize utility allowances and conserve rental assistance).

b) Describe the plan to utilize energy conservation practices in the common areas of the project (to conserve operating expense and help minimize rent/occupancy charge levels).

c) Describe the project objective in implementing energy conservation measures.

12. Plans for tenant participation in rural rental housing (RRH) project operations and tenant's relationship with management.

a) Describe any plans for a tenant organization and how management and staff will work with the organization.

b) Describe where the Tenant Grievance and Appeals Procedure will be posted in the project and otherwise made available to tenants. Identify which person or staff position will be responsible for responses to and consideration of a tenant/member grievance.

13. Plans for member participation in rural cooperative housing (RCH) project operations.

a) Describe who will explain to the members the types of committees the cooperative will be using.

b) Describe what the cooperative will do to attract member participation on committees.

c) Describe how the board members will participate with the committee.

d) Describe where the cooperative will post, and otherwise make available to members, the Tenant Grievance and Appeals Procedure. Identify which person or staff position will be responsible for response to and consideration of a member grievance.

14. Plan for carrying out management training programs.

a) Describe the standards of training and proficiency that management or board members will be expected to attain and maintain to perform their duties and responsibilities in carrying out project objectives, including compliance with applicable Federal, State, and local laws.

b) Describe the plan to conduct internal training and to otherwise use external training sources to maintain levels of attained proficiency.

c) For RCH, describe the actions the board will take if a board member(s) does not participate in training.

d) For RCH, describe the role the board will assume in making sure the RCH membership as a whole understands its role and functions in the cooperative.

15. Termination of leases or occupancy agreements and eviction.

a) Identify which person or staff position is responsible for knowing and administering State and local laws and Rural Development's requirements regarding termination of leases or occupancy agreements and evictions.

b) Identify which person or staff position is responsible for knowing and administering State and local laws and Rural Development's requirements regarding the notification that must be given to a tenant or member when termination of lease or occupancy agreement is proposed and subsequent eviction procedures through the State or local judicial process.

16. Insurance.

a) Identify which person or staff position is responsible for knowing and complying with Rural Development requirements for fidelity coverage and acquiring such coverage.

b) Identify which person or staff position is responsible for knowing and complying with Rural Development's insurance coverage requirements and acquiring such coverage.

17. Management agreement. Attach a copy of the management agreement, when applicable. (If an initial loan, attach a copy of the proposed management agreement, when applicable.)

18. RCH board of director/adviser relationship. Discuss the relationship of the adviser and its effect on decisions made by the board.

19. Management compensation.

a) If management is provided directly by the owner, describe the amount of management fee, how it will be determined, and how it will be paid.

b) In the case of a cooperative, describe the amount of compensation to be paid to the adviser by the board.

20. On-site management.

a) Describe who (owner, site manager, caretaker, board) will perform on-site management duties and responsibilities.

b) Describe the duties and responsibilities of the on-site management staff.

c) Identify whether the site manager will live in the project in a rent-free unit, pay rent, or live off-site.

d) Describe established office hours and indicate where they will be posted.

21. Validity of the management plan. The plan must provide space at the end for the date, title, and signature of borrower or borrower's authorized representative.

ATTACHMENT 3-B

BORROWER CERTIFICATION THAT NO CHANGES ARE REQUIRED TO THE MANAGEMENT PLAN

(To be submitted once every 3 years if no changes are needed to the management plan during that period)

I, _____, certify that there have been no changes in the project's operations during the last 3 years, that the project operations are consistent with the current management plan, and that the plan is adequate to ensure project compliance with the loan documents and the applicable Agency requirements.

_____
(Borrower)

ATTACHMENT 3-C

FREQUENTLY ASKED QUESTIONS (FAQ)

NONDISCRIMINATION POLICIES AND PRACTICES BORROWERS MUST ADDRESS

- How will applicants and tenants be made aware that the owner will provide reasonable accommodations?
- How will requests for reasonable accommodations be handled and who is authorized to approve or deny any such requests?
- Does the project have a Telecommunication Device for the Deaf (TDD) or an *equally effective communication system*? (Note: If the complex has Section 8 assistance from HUD, the complex is required to have a TDD)
- If the project has a TDD, is the public made aware that there is a TDD? For example, is the TDD telephone number given each time the project's telephone number is given?
- If the project relies on a relay service as an *equally effective communication system* (rather than having a TDD), who operates the relay service? Is the relay service available 24 hours a day and without any added cost to the disabled person?
- Have procedures been established to accommodate hearing- and sight-impaired applicants and tenants? Examples of methods the borrower might use include readers, sign language interpreters, Braille, etc.
- Does management give priority for fully accessible units to persons <u>who are in need of the special design features</u> of an accessible unit? Is priority given first to those living in the complex and then to persons on the waiting list?
- Before accessible units are temporarily rented to people who do not need the special design features, have there been diligent marketing efforts to <u>market the units as accessible units</u>? Have those efforts been documented? Are lease clauses used? Do marketing efforts continue after renting the unit to someone who does not need the special design features?
- Is management's policy for verifying a person's disability limited to only that which is needed to establish eligibility and is verification required only <u>after</u> a tenant or applicant has asked that their disability be considered by management?
- Does management provide their employees with civil rights training?
- When marketing an elderly project, has there been an effort to reach all eligible people? Persons with disabilities (of any age) are every bit as eligible as persons who are 62 or older. Marketing efforts should be designed to reach both population groups.

- Does the borrower/management agent notify the public that they do not discriminate on the basis of disability? Do materials published by the borrower contain such a notice? Use of the Equal Housing Opportunity logo is one means of doing so (the logo is the house with the equal sign and the words Equal Housing Opportunity underneath the house).

- Does management have a policy that permits persons with disabilities to have service and/or companion animals?

- Does management give persons with disabilities the same choices other applicants are given? For example, the choice to pick either first or second floor apartments.

ATTACHMENT 3-D

COSTS AND SERVICES TO BE PAID FROM THE MANAGEMENT FEE

The following items and services are provided in return for the management fee:

A. Supervision by the management agent and staff (time, knowledge, and expertise) of overall operations and capital improvements of the site.

B. Hiring, supervision, and termination of onsite staff.

C. General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all onsite employees including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and Workers' Compensation reports, and other IRS or state-required reports.

D. Preparation and submission of proposed annual budgets and negotiations for approval with RHS, HUD, or other governmental agencies and the borrowers.

E. Preparation and distribution of RHS, HUD, Housing Finance Authority (HFA), or other governmental agency and normal financial reports to borrowers, RHS, HUD, HFA, or other governmental agency.

F. Preparation and distribution of required year-end reports to RHS, HUD, HFA, or other governmental agency and borrowers.

G. Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.

H. Arrangement of preparation by outside contractors of Energy Audits and Utility Allowance analysis. Implementation of appropriate changes.

I. Preparation and implementation of Affirmative Fair Housing Marketing Plans (AFHMPs) as well as general marketing plans and efforts.

J. Reviews of tenant certifications and submission of monthly Rental Assistance requests, overage, and monies collected for occupancy surcharge. Submission of payments where required.

K. Preparation, approval, and distribution of operating disbursements and oversight of project receipts and reconciliation of deposits.

L. Overhead of management agent including:

- Establishment, maintenance, and control of an accounting system adequate to carry out accounting supervision responsibilities.

- Maintenance of agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, RHS, HUD, HFA, or other governmental agency and with the borrowers and the main office.

- Postage expenses related to the normal responsibility for mailings to the properties, RHS, HUD, HFA, or other governmental agency, the tenants, the vendors and the borrowers.

- Expense of telephone and facsimile communication to the properties, tenants, RHS, HUD, HFA, or other governmental agency and the borrowers.

- Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.), directly related to protection of the funds and records of the borrower.

- Central office staff training and ongoing certifications.

- Maintenance of all required profession and business licenses and permits. (This does not include site office permits or licenses.)

- Insurance coverage for Agents office and operations (Property, Auto, Liability, Errors and Omissions (E&O), Casualty, Workers' Compensation, etc.).

- Travel of Agent staff to the properties for onsite inspection, training, or supervision activities.

- Agent bookkeeping for their own business.

M. Attendance at meetings (including travel) with tenants, borrowers, investors, and/or RHS, HUD, HFA, or other governmental agency.

N. Development, preparation, and revision of management plans and/or agreements.

O. Coordination of HUD vouchers with tenants including reporting to all pertinent agencies and borrowers.

P. Direct the investment of project funds into required accounts.

Q. Maintenance of bank accounts and monthly reconciliations.

R. Preparation, request for, and disbursement of borrower’s initial operating capital (for new projects), as well as administration of annual return to borrower.

S. Account maintenance, settlement, and disbursement of security deposits.

T. Work with auditors for initial setup of audits and annually thereafter for audit preparation and review. Assistance with supplemental letters and preparation of *Form RD 3560-10, Borrower Balance Sheet*, as well as other RHS, HUD, HFA, or other governmental agency reports.

U. Storage of records and adherence to records retention requirements.

V. Assistance to onsite staff with tenant relations and problems. Assistance in severe actions (eviction, death, insurance loss, etc.).

W. Oversight of general and preventive maintenance procedures and policies.

X. Development and oversight of asset replacement plans.

Y. Oversight of preparation of Section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and Section 504 requirements.

Z. Reporting to general and limited partners and State Agencies for LIHTC compliance purposes.

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ATTACHMENT 3-E

COSTS AND SERVICES TO BE PAID FROM PROJECT INCOME

There are some generally accepted project expenses that may be paid out of the project operating account. These expenses are listed below.

A. Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. These will include managers, maintenance staff, and temporary help and can include the following specific items:

- Gross salary;
- Employer Federal Insurance Contributions Act (FICA) contribution;
- Federal unemployment tax;
- State unemployment tax;
- Workers' compensation insurance;
- Health insurance premiums;
- Cost of fidelity or comparable insurance;
- Leasing, performance incentive, or annual bonuses;
- Direct costs of travel to offsite locations by onsite staff for property business or training; and
- Retirement benefits.

B. Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and other project-related matters.

C. All outside account and auditing fees, if required by RHS, directly related to the preparation of the annual audit, partnership tax returns, and Schedule K-1, as well as other outside reports and year-end reports to RHS, HUD, FHA, or other governmental agency.

D. All repair and maintenance costs for the project, including:

- Maintenance staffing costs and related expenses;
- Maintenance supplies;
- Contract repairs to the projects (heating and air conditioning, painting, roofing, etc.);

- Make-ready expenses, including painting and repairs, flooring replacement, and appliance replacement, as well as drapery/mini-blind replacement (turnover maintenance);
- Preventive maintenance expenses, including occupied units repairs and maintenance, as well as common area systems repairs and maintenance;
- Costs of snow removal;
- Costs of elevator repairs and maintenance contracts;
- Costs of Section 504 compliance;
- Costs of landscaping maintenance, replacements, and seasonal plantings;
- Costs of pest control services; and
- Other related maintenance expenses.

E. Specific costs that may be charged to the project include:

- The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.
- The costs of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.
- All bank charges related to the property including purchases of supplies (stamps, checks, deposit slips, returned check fees, service fees, etc.).
- Costs of site-based telephone, including initial installation, basic services, directory listings, and long distances charges.
- All advertising costs related specifically to the operations of that project. These can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.
- Postage and delivery costs from the site, including expenses to RHS, HUD, or other governmental agencies; tenants; verifying third parties; central management offices; etc.
- Partnership filing expenses, including state taxes and other mandated state or local fees. Costs of continuation financing statements and site license and permit costs.
- Expenses related to site utilities, including actual costs and surcharges, as well as deposits and expense of utility bonds in lieu of bonds.

- Site office furniture and equipment including site-based computer and copiers. Service agreements and warranties for copiers, telephone systems, and computers are also included (if approved by RHS and make good business sense).

- Real estate taxes (personal/tangible property and real property taxes) and expenses related to controlling or reducing taxes.

- All costs of insurance, including property liability and casualty, as well as fidelity or crime and dishonesty coverage for onsite employees and the general partners.

- Costs of collecting rents onsite, including bookkeeping supplies and record keeping items.

- Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies, and other associated expenses.

- Public relations expenses related to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. For example, Chamber of Commerce duties, contributions to local charity events, sponsorship of tenant activities, etc.

- Tax Credit Compliance Monitoring Fees imposed by HFAs.

- All insurance deductibles, as well as adjuster expenses.

- Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation, and inspection contracts, etc.).

- Site manager salary for additional hours associated with congregate housing.

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Fiscal Year 2019
Per Occupied Unit Per Month State Maximum Management Fee

STATE	FY 2018 Fee	2018 OCAF %	Fee x OCAF	FY 2019 Fee (Rounded-Up)
Alabama	$55	2.30	1.27	$57
Alaska	$58	2.90	1.68	$60
Alaska –off-road	$69	2.90	2.00	$72
Arizona	$58	2.00	1.16	$60
Arkansas	$62	2.20	1.36	$64
California	$66	2.40	1.58	$68
Colorado	$60	1.90	1.14	$62
Connecticut	$66	2.20	1.45	$68
Delaware	$59	2.10	1.24	$61
Florida	$56	2.10	1.18	$58
Georgia	$55	2.20	1.21	$57
Hawaii	$69	0.90	0.62	$70
Hawaii – off-road	$79	0.90	0.71	$80
Idaho	$55	2.40	1.32	$57
Illinois	$50	2.20	1.10	$52
Indiana	$50	2.10	1.05	$52
Iowa	$50	2.50	1.25	$52
Kansas	$54	2.40	1.30	$56
Kentucky	$49	2.10	1.03	$51
Louisiana	$62	2.10	1.30	$64
Maine	$66	1.60	1.06	$68
Maryland	$60	2.30	1.38	$62
Massachusetts	$69	1.90	1.31	$71
Michigan	$50	2.20	1.10	$52
Minnesota	$55	2.20	1.21	$57
Mississippi	$59	2.00	1.18	$61
Missouri	$51	1.80	0.92	$52
Montana	$61	1.90	1.16	$63
Nebraska	$54	2.20	1.19	$56
Nevada	$61	1.80	1.10	$63
New Hampshire	$66	2.00	1.32	$68
New Jersey	$59	2.40	1.42	$61
New Mexico	$51	1.70	0.87	$52
New York	$59	2.00	1.18	$61
North Carolina	$60	2.10	1.26	$62

* - Operating Cost Adjustment Factor (OCAF)

Fiscal Year 2019
Per Occupied Unit Per Month State Maximum Management Fee

STATE	FY 2018 Fee	2018 OCAF %	Fee x OCAF	FY 2019 Fee (Rounded-Up)
North Dakota	$60	2.50	1.50	$62
Ohio	$51	1.90	0.97	$52
Oklahoma	$62	2.10	1.30	$64
Oregon	$60	2.30	1.38	$62
Pennsylvania	$59	2.10	1.24	$61
Puerto Rico	$51	2.00	1.02	$53
Rhode Island	$67	1.90	1.27	$69
South Carolina	$60	2.30	1.38	$62
South Dakota	$61	2.40	1.46	$63
Tennessee	$50	2.20	1.10	$52
Texas	$62	2.20	1.36	$64
Utah	$52	2.20	1.14	$54
Vermont	$64	2.20	1.41	$66
Virgin Islands	$60	2.00	1.20	$62
Virginia	$61	2.10	1.28	$63
Washington	$60	2.30	1.38	$62
West Virginia	$54	2.80	1.51	$56
Wisconsin	$52	2.30	1.20	$54
Wyoming	$54	2.10	1.13	$56

* - Operating Cost Adjustment Factor (OCAF)

CHAPTER 4: FINANCIAL MANAGEMENT

4.1 INTRODUCTION

Successful projects require sound financial management procedures to track funds, prepare realistic budgets, manage project funds effectively, and report financial progress. This chapter covers the borrower's financial management responsibilities and provides guidance to Loan Servicers on monitoring a borrower's financial management performance.

The chapter is divided into five sections:

Section 1: Project Accounting System describes program requirements and Agency monitoring responsibilities for the project accounting system.

Section 2: Project Accounts discusses the contribution, use, and monitoring of project accounts.

Section 3: Reserve Accounts outlines the requirements for and monitoring of reserve accounts.

Section 4: Project Budgets explains project proposed budget requirements and the budget approval process.

Section 5: Reporting and Financial Examination describes project actual reporting and financial examinations and Agency review of these reports.

SECTION 1: PROJECT ACCOUNTING SYSTEM

4.2 OVERVIEW OF ACCOUNTING SYSTEM REQUIREMENTS *[7 CFR 3560.302]*

Borrowers must establish accounting systems that support safe and sound project financial management. The accounting system must allow borrowers to maintain records in a manner suitable for an audit; track the use of funds, report accurate operational results to the Agency, and otherwise comply with the terms of their loan agreement. The following requirements apply to the borrower's accounting system:

- Agency approval. The accounting system must be approved by the Agency as part of the management plan (as discussed in Chapter 3). The borrower must notify the Agency of any changes in the method or system of accounting through a revision to the project management plan.

- Method of accounting. The borrower is required to use the accrual method of accounting throughout the year for bookkeeping and budget preparations. Annual reporting must be convertible to the standards identified in §3560.308.

- When the accrual method of accounting is used, the accrual-to-cash adjustment must equal the difference between Beginning Cash Balance and Ending Cash Balance to ensure these balances match their respective Balance Sheet figures. The sole purpose of this adjustment is to reconcile a company's internal ledger, kept on an accrual basis, to the IRS forms which are on a cash basis.

- Recordkeeping. Borrowers must retain all financial records and supporting material for at least 3 years after the issuance of annual financial reports and financial statements or until the next Agency monitoring visit whichever is longer. These records must be maintained in a manner that can be audited by the Agency or a third party. Records may need to be retained longer for IRS retention rules or Tax Credit Guidelines. Borrower accounts and records will be made available in a location with reasonable access for review at the request of the Agency.

If an account is a problem case or an investigation or audit is in process, do not destroy material until the problem is resolved or the investigation audit is closed.

- **Account requirements.** The following general requirements apply to the borrower's accounts:

  ◊ Accounts must be held in domestic institutions;

  ◊ Accounts must be insured by an agency of the Federal Government, backed by collateral approved by the bank, or held in securities meeting the requirements of 7 CFR part 3560, subpart G;

  ◊ Funds maintained in an institution may not exceed the limit established for Federal deposit insurance. If funds at any one institution exceed the amount covered by Federal deposit insurance, borrowers must obtain a collateral pledge from the institution to cover all funds, or must move funds to an institution that will insure funds; and

  ◊ Borrowers must maintain at least one demand deposit or checking account so that funds are always readily available to pay necessary operating expenses.

- **Use of funds.** Funds other than those in the security deposit/membership fee or patron capital accounts serve as security for the Agency grant or loan and must be held in trust by the borrower until used.

  ◊ In no case may project funds be pledged as collateral for non-project debts;

◊ Funds must be used only for authorized purposes as described in 7 CFR part 3560, subpart G and in the project loan agreement or resolution; and

◊ Priority Order of planned and actual project expenditures are discussed in 7 CFR, part 3560, subpart G.

- **Separate accountability.** The accounting system must establish separate accountability for different projects. Funds for housing projects managed by the same management company must not be co-mingled.

  The borrower may combine funds from different projects owned by the same borrower with the same tax identification number or Social Security Number in the same bank account, as long as the accounting system segregates and tracks each project's funds separately. A statement issued by a Certified Public Accountant (CPA) stating that the accounting system is structured to meet the principle of separate accountability will be provided. If funds for different projects are combined, the management plan must document how revenue and expenses that are not clearly associated with a particular project are prorated across projects. For example, the plan must document how costs for a computer system that serves several projects are allocated across the projects. The accounting system must track these prorated costs.

4.3 OVERVIEW OF ACCOUNTS

The borrowers must establish and maintain the accounts required by their loan agreement or resolution. At a minimum, these include the following accounts:

- General operating account;
- Tax and insurance account (amounts escrowed may be part of the general operating account but tracked separately);
- Reserve account;
- Tenant security deposit account
- Membership fee account (if applicable); and
- For cooperative projects, a patron capital account.

Each account serves a different purpose, as described in Section 2 and the project loan agreement or resolution.

SECTION 2: PROJECT ACCOUNTS

4.4 GENERAL OPERATING ACCOUNT

The borrower must establish a general operating account to handle all revenues and expenses associated with project operations. Authorized expenses payable from this account include expenses that are directly attributable to project operations and are necessary to carry out successful project operations. Attachment 4-C addresses eligible and ineligible operating expenses.

A. Initial Operating Capital and Other Advances [7 CFR 3560.304].

The period between initial occupancy and full rent-up in a project can be risky because rental income may not be sufficient to cover all operating costs, make payments on the Agency loan, and make required contributions to the reserve fund. To assist projects through this phase, the Agency requires the establishment of a fund for Initial Operating Capital by the borrower for each project. Approval of subsequent loans, transfer of ownership or other servicing actions may require additional deposits to the Operating Account and will be described in the loan, transfer or servicing approval.

This Initial Operating Capital is to be used for initial operating expenses, such as advertising, insurance, fidelity coverage, and initial lease-up expenses. The funds may also be used to meet project obligations, such as debt payments and reserve deposits, until cash flow is sufficient to fund these accounts. In addition to these regular operating expenses, there are some special expenses associated with this period, such as purchasing furniture or equipment for public spaces or advertising and marketing. Borrowers are to provide the Agency with a list of proposed uses for Initial Operating Capital during loan origination.

Other Advances include any advances made by the borrower, borrower entity, or designee to cover ordinary project operating expenses.

- **Funding of Initial Operating Capital**

  All borrowers must provide Initial Operating Capital equal to at least 2 percent of the total development costs to support initial operation of the project. Borrowers must put this amount down at the loan closing or construction start, whichever comes first. The Agency may loan the required 2 percent to not-for-profit borrowers. (For details on this process, see Chapter 5 of HB-1-3560.)

- **Accounting for Initial Operating Capital**

  When the project accounts are established, Initial Operating Capital is blended with other revenue and used for operating expenses. The borrower may leave an amount of money equal to the initial capitalization of the fund in the operating

account. This money should not be treated as surplus funds in the operating account nor should it be transferred to reserves. Its presence in the operating account should not be used as justification for the Loan Servicer to deny a rent increase.

- **Duration of Initial Occupancy**

The initial occupancy phase lasts until the project has attained a stable occupancy rate and the operating budget can reliably be supported by rental income. Projects vary as to when they achieve this stability; the Agency anticipates it occurs sometime between the end of the second and seventh year of occupancy. When project stability is reached before the end of the seventh year, a for-profit borrower whose cash contribution created the Initial Operating Capital may request that the contribution be repaid.

- **Repayment**

◊ **Agency Policy**

The borrower may, with the consent of the Agency, withdraw its original contribution to the Initial Operating Capital in multiple annual installments or a single installment after the second year of the housing project operations and prior to the seventh full year of project operation, provided the borrower can satisfy Agency criteria for approving repayment. Repayment can only be made once the project has been operating for 2 years, and the project's operations and finances have stabilized. Repayment may be requested in one to five annual installments, until the borrower's contribution to Initial Operating Capital has been fully repaid and prior to the close of year seven. The borrower must be able to demonstrate that the project is financially stable, that repayment will not require a rent increase, and that the project is in compliance with Agency requirements. The financial condition of the project may preclude full repayment of Initial Operating Capital.

◊ **Borrower Submissions**

The borrower may submit a request for repayment of Initial Operating Capital when the annual financial report is submitted. The borrower's request is submitted in writing and addressed to the Servicing Office.
The submission should specify the amount of the repayment the borrower is requesting in the current year and, if applicable, the borrower's plan for withdrawing the balance of the repayment in ensuing years. The submission includes documentation demonstrating how the project meets Agency criteria for repayment:

- **Occupancy.** The occupancy rate for the project over the most recent 12 months has averaged at least 90 percent.

- **Contributions to Reserves.** Contributions to reserves are on schedule, less any authorized withdrawals.

- **Sufficient Income.** The project's financial position is stable. All accounts payables are less than 30 days old. When the amount of the repayment is subtracted from the general operating account, the ending cash balance still includes an amount equal to 20 percent of projected annual operating costs and required escrows for taxes and insurance.

- **Impact on Rents:**

  - Repayment is acceptable if no rent increases are projected in the year the repayment is made.

  - A rent increase will not affect repayment if rents are increasing to cover increases in costs, such as wages, taxes, or insurance.

  - Repayment is denied if it creates a shortfall in operating income that must be made up by a rent increase and/or funded by the owner.

- **Physical Maintenance.** There are no outstanding deficiencies in management's physical maintenance of the housing project in accordance with 7 CFR 3560.354**.**

- **Compliance.** There are no outstanding compliance violations, and the project is not under a workout agreement.

◊ **Agency Processing**

Agency staff will examine the submission for eligibility, completeness, and compliance with the criteria the Agency has established that a project must meet for a repayment to be made. If staff finds that the project can support the repayment, the repayment amount will be calculated.

- **Amount of Repayment**

  The borrower may receive a lump sum amount equal to the original contribution of Initial Operating Capital, or smaller amounts in installments if the operating budget cannot support repayment in a single lump sum amount (see Example below).

Example – Initial Operating Capital			
	Case One	Case Two	Case Three
Year-end cash balance	$57,000	$40,000	$27,000
20% O&M requirement plus taxes & insur.	27,000	27,000	27,000
Surplus	**30,000**	**13,000**	**0**
Initial Operating Capital	30,000	30,000	30,000
Repayment Amount	**30,000**	**13,000**	**0**
Initial Operating Capital unpaid balance	0	17,000	30,000

- The borrower in Case One can be repaid in a single installment.
- The borrower in Case Two will require 3 installments assuming little change in the project's financial condition.
- The borrower in Case Three could not receive any repayment this year.

- **The Decision Process**

  - The Servicing Office has 60 calendar days to review the annual financial statement, including any request for repayment of Initial Operating Capital.

  - The Servicing Office may decide to:

    - Permit repayment in the amount requested by the borrower;

    - Permit repayments, but in an amount less than that requested by the borrower; or

    - Deny repayment because the project does not meet the criteria for repayment.

  - The decision of the Servicing Office is provided to the borrower in a letter. In addition to the amount of any authorized repayment or the reasons for denying repayment, the letter states the amount of any remaining unpaid balance of the original contribution to Initial Operating Capital. If repayment is denied appeal rights will be sent.

  - The Servicing Office updates Multi-Family Integrated System (MFIS) Tracked accounts and Servicing efforts to show the amount of the authorized repayment and the unpaid balance of Initial Operating Capital.

- **Other Borrower Advances**

  Prior written approval by the Loan Servicer is required for any advances made by the borrower, borrower entity, or designee to cover ordinary project operating expenses. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short term in nature, a servicing plan may be developed, and advances may be approved if justified by the following:

  - A review of the documented circumstances and the project operating budget before any funds are advanced. The financial position of the project must not be jeopardized.

  - Funds are not immediately available from any of the following sources:

    - Reserve funds;
    - Initial operating capital; or
    - An imminent rent increase.

  The borrower may charge or be paid interest on the loan using project income; however, interest must be reasonable. The proposed loan may be denied if Agency financing can be provided to resolve the problem in a more cost-effective manner.

  No lien in connection with the loan will be filed against the property securing the Agency's loan or against project income. The advance may be shown as an unsecured project liability on financial statements prepared for year-end reports until such time as it is authorized to be repaid.

- Repayment of Advanced Loan Funds

  The repayment of the advance may be permitted by the Loan Servicer, provided the terms and conditions were mutually agreed to by the borrower and the Agency at the time of the advance, and the financial position of the project will not be jeopardized. Repayment should only be permitted on the advance when the Agency debt is current, and the reserve requirements are being maintained in accordance with Section 3 of this chapter.

B. Return on Investment/Return to Owner [7 CFR 3560.305]

The borrower's Return on Investment (ROI) is the annual amount of profit an owner operating on a limited or full-profit basis may receive from a project, as established in the loan agreement. When a property has a transfer of ownership,

ROI is referred to as a Return to Owner (RTO) and is based upon the transfer underwriting analysis and approval conditions. The amount is calculated as a percentage of the owner's investment in the project.

The borrower may take the earned ROI/RTO (Return) before withdrawing the original contribution to Initial Operating Capital. A full or partial Return may be taken in a given year. If only a partial is taken, the remainder may be taken the following year if allowed. The borrower may receive a Return in accordance with the terms of its loan agreement, and if the following conditions exist:

1. The borrower may take the Return budgeted and approved after the project's fiscal year ends if there is a positive net cash flow (see line 30 on *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*), and the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals.

   When determining positive net cash flow, the Agency will consider such items as accounts payable and reserve withdrawals to cover operating expenses. For example, the borrower may not circumvent the order for funding accounts by using reserve funds or creating an accounts payable for budgeted operating expenses to make it appear as though the budget has a positive cash flow at year end. If the annual financial reports indicate that the borrower should not have taken a Return, the Agency will require the borrower to repay the unauthorized Return to the project.

2. If the project's operations show a negative cash flow (see Form RD 3560-7, line 30) as in the Example, Case 1 below, the Agency may authorize the borrower to take the Return only after the Agency has reviewed the project's annual financial report and determines:

   ◊ There is surplus cash in either the general operating account or the reserve account and;

   ◊ The housing project has sufficient funds to address identified capital or operational needs. Needs of the property may be identified by inspections and/or capital needs proposed.

   The Agency considers surplus cash to be the portion of the ending cash balance on *Form RD 3560-7* that after all payables, exceeds 20 percent of projected annual operating and maintenance expenses, the taxes and insurance escrow, and initial operating capital, if applicable. To determine surplus cash, refer to Attachment 4-D, *PROPOSED BUDGET AND YEAR END ANALYSIS PROCESS*.

An earned, but unpaid Return for the previous year may only be requested if, at the end of a project's current fiscal year, surplus project funds are more than sufficient to pay Return for the year just ended. The borrower mayrequest that the additional surplus project funds be used to pay any portion of the prior year's Return that could not be paid previously. See Example Payment of Return, Case

3. The borrower will indicate the year the Return being withdrawn represents on Form RD 3560-7, Part I, line 23 under "Comments".

4. The borrower may request the Return from the reserve account if the conditions set out in the loan agreement are met and the account balance is greater than the required deposits minus authorized withdrawals. After the disbursement the reserve account actual balance must be equal to or greater than the required balance. The disbursement does not reduce the required balance.

C. Surplus Funds [7 CFR 3560.306]

If the general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit into the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year.

Example- Payment of Return

Consider a project that has been operational for 8 years, has a $1,000 Return specified in the loan agreement, and needs $10,000 cash to cover 20 percent of annual operating and maintenance expenses, and taxes and insurance escrow.

Case 1: If the project had a negative cash flow after payment of operating and maintenance expenses, reserves, and debt service expenses during the fiscal year (FY) 20X7 but had $20,000 available in the general operating account, the Agency would approve a Return from funds available at the end of FY 20X7. In this example, "FY 20X7 RTO" would be noted in the comments section of *Form 3560-7*. This Return would be taken immediately after the end of the fiscal year, preferably January 20X8.
After the $1,000 RTO was paid, if all or a portion of the previous year (20X6) RTO is unpaid - it may be paid from the remaining surplus cash. Any remaining previous years unpaid RTO will then be written off.

Case 2: If the project had a negative cash flow during FY 20X7 but had only $5,000 available in the general operating account, the Agency would not approve a Return from funds available at the end of FY 20X7. This FY 20X7 RTO could be requested the following year if there is surplus cash to cover it, the 20X8 RTO is paid first and it does not cause a rent increase. The Return would be taken immediately after the end of the fiscal year, preferably January 20X9.

Case 3: Consider the same project as described above. During FY 20X7, the borrower believed that there would not be adequate cash to pay taxes at year end, so the borrower requested $2,000 from the reserve account for operating purposes; however, the project ended the year with $3,000 positive cash flow. In this case, the borrower can take the $1,000 without Agency permission, as they used a reserve withdrawal request to cover operating expenses. However, if the net cash amount was less than $2,000, the borrower can only take Return from surplus cash.

	Case One	Case Two	Case Three
Form RD 3560-7 Part I Line 30	$ (2,000)	$ (2,000)	$ 3,000
Form RD 3560-7 Part I Line 33	$ 20,000	$ 5,000	
Tax & Ins escrow	$ (5,000)	$ (5,000)	
Accounts Payable	$ (2,500)	$ (2,500)	
Cash Available	$ 12,500	$ 0	
Cash Required (20% proposed O&M - Tax & Insurance)	$(10,000)	$(10,000)	
Surplus Cash	$ 2,500	$ 0	

4.5 TAX AND INSURANCE ACCOUNT

The borrower must deposit money on a monthly basis to pay required taxes and insurance. Generally, these funds can be kept in the general operating account as long as they are tracked separately from other general operating funds to ensure that funds are available to pay taxes and insurance. In some cases, however, the Agency may require a separate account for taxes and insurance to ensure the availability of these funds. See Chapter 3 for a discussion of insurance requirements and taxes. Also, see Attachment 4-D Budget and Year End Analysis for evaluation of escrow amounts.

4.6 RESERVE ACCOUNT

The reserve account is used primarily to pay for large planned expenses for maintenance and improvements of capital items. It is funded through contributions from project operating funds. The reserves are not to be used as an alternative operating budget. The project's reserves must be held in an account with a current executed Depository Agreement that requires the Agency's approval on all withdrawals. The administration of project reserves is covered in detail in Section 3 of this chapter.

4.7 SECURITY DEPOSIT OR MEMBERSHIP FEE ACCOUNT

The security deposit or membership fee account holds funds provided by residents as security deposits and membership fees. See Chapter 7 for a full discussion of security deposits and membership fees.

- **Uses of Funds.** Funds deposited in the security deposit/membership fee account must be used for purposes outlined in the management plan:

  ◊ The borrower may only use security deposits to cover costs of fixing damage to units beyond ordinary wear and tear by the tenant who provided the deposit. The funds must be returned to the tenant if not used in accordance with the State Law. If the borrower cannot locate the tenant to return the deposit, these funds must be deposited in the general operating account or handled in accordance with applicable state laws. In cooperatives, the return of membership fees depends upon the legal instruments governing the project.

  ◊ Funds retained by the borrower as a result of a lease or occupancy violation must be transferred to the general operating account and treated as project income.

◊ **Interest.** The interest on security deposit/membership fee accounts is handled in accordance with state law. If no state law governs the use of interest, it must be deposited in the general operating account, at least annually, and used for general operating expenses. In no case may interest accrue to the benefit of the borrower or management agent.

4.8 PATRON CAPITAL ACCOUNT

In cooperative projects, borrowers must establish a patron capital account to hold surplus operating funds in trust for cooperative shareholders.

- Any funds in excess of 3 months of average operating expenses remaining in the general operating account at the end of the fiscal year must be deposited in the patron capital account. This account must be interest bearing and must be administered according to state laws governing patronage capital.

- Each shareholder of the cooperative association must be assigned an equal portion of the funds in this account. These funds are held in trust for the shareholders of the association until they terminate their membership in the cooperative. Shareholders may receive their portion of the funds only if they have paid all association charges and costs due the cooperative association.

SECTION 3: RESERVE ACCOUNT *[7 CFR 3560.306]*

4.9 PURPOSE OF RESERVES

The Agency has a financial interest in a project over the life of its loan. During this period, which can be as long as 50 years, major replacements and capital expenditures will have to be made to the building, such as replacing the roof, rewiring, replacing windows, doing major exterior work, or adding new kitchen and bathroom fixtures. The reserve account is primarily used to meet the major capital expense needs of a project. If these expenditures are not made, the property loses value, becomes less attractive to tenants, and begins to deteriorate. The Agency's financial interest in the project is then at risk.

Adequate replacement reserves are a critical component of a successful project. The reserves are not to be used as an alternative operating budget. Rents should reflect and cover the reasonable and customary costs of annual operating expenses of the property in the market. Annual reserve deposit for projects with Agency approved Capital Needs Assessments (CNA) will be adjusted as authorized in the loan, transfer or servicing approval.

4.10 RESERVE ACCOUNT REQUIREMENTS

The reserve account is a required account subject to the requirements set out in this paragraph. The borrower will initiate deposits in this project account, starting in the same month the first loan payment is due the Agency. As projects age, the required reserve account level may be adjusted to meet anticipated life-cycle needs, such as equipment and facility replacement costs, by amending the loan agreement/resolution. Refer to Attachment 4-B for guidance on the amendment. Requirements for the reserve account include the following:

- All Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing borrowers are required to establish and maintain a reserve account. This requirement excludes On-Farm Labor Housing borrowers with fewer than12 units.

- Reserve accounts must be deposited in interest-bearing accounts or securities with rates greater than or equal to savings or checking accounts.

- Reserve funds are required to be placed in a supervised account or have an Agency accepted Depository Agreement approved by the Agency, executed after October 1, 2018. With the updated Depository Agreement, the Agency is no longer required to countersign approved withdrawals from reserve accounts as provided by 7 CFR 3560.306(e)(2) and 7 CFR 1902.4(a)(1).

- Agency approval must be obtained prior to the withdrawal of any reserve account funds per 7 CFR 3560.306 and MFH Handbook (HB)-2-3560 Chapter 4, Section 3. If the Agency finds any unauthorized Reserve account usage, the Agency will take the appropriate servicing actions.

- Any amount in the reserve account that exceeds the total sum specified in the loan agreement or resolution may be transferred to the general operating account for authorized purposes only when it is agreed, between the borrower and the Agency, to be in excess of the requirement and there is a specific need for the excess funds. However, the Loan Servicer may direct the excess sum to be retained in the reserve account or applied as an extra payment on the loan.

- Section 515 properties leveraged with 538 Guarantee Rural Rental Housing (GRRH) program funding are not subject to countersignature requirements. Direct Section 515 loan borrowers, exempted from the counter-signature requirements, must comply with the Section 538 GRRH program regulatory requirements. In all cases, the Section 538 lender must get prior written approval from the Agency before reserve account funds involving a direct MFH loan project can be disbursed to the borrower.

4.11 RESERVE INSTALLMENTS

Required reserve installments will be transferred to the reserve account at least at the rate stipulated by the borrower's loan agreement or resolution, starting with the date the first loan payment is due to the Agency. Transfers of funds to the reserve account will continue until the account reaches the total amount specified in the loan agreement or resolution. Transfers will be resumed the period following withdrawals that decrease the reserve account balance below its fully funded level until it is restored to the specified total minimum sum.

The Agency may approve a change in the borrower/projects reserve account funding level based on the findings of an approved Capital Needs Assessment (CNA). The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area. If the borrower requests an increase in the project's annual reserve account deposits, the borrower must have

a capital needs assessment prepared and submitted to the Agency to reflect the project's anticipated needs for replacement of capital equipment and systems. The cost for preparation of a CNA will be approved by the Agency as an eligible project expense for existing owners, provided that the cost of the assessment is reasonable and meets Agency requirements. (Note: CNA's required by transferees for ownership changes are not eligible for payment from the reserve account unless the transferee is also a non-profit entity and no additional third party is providing funds for acquisition or rehab.)

The Agency may approve a borrower's request to increase the fully funded level of the reserve account to ensure sufficient funds are available to address the capital requirements of a Transition Plan.

The following definitions are displayed on the MFIS Tracked Accounts page, and are used to further explain the reserve account:

- **Required Balance.** The amount that the reserve account is required to contain as of the date displayed. This amount is calculated by adding deposits as required by the loan agreement/resolution and subtracting authorized withdrawals.

- **Fully Funded.** The amount set in the borrower's loan agreement/resolution for funds to be set aside during the life of the project.

- **Annual Deposit.** The amount of funds that must be deposited annually to the reserve account according to the borrower's loan agreement/resolution.

- **Account Balance.** The account balance as of the date displayed. This would correspond to the reserve section actual balance on financial reports.

- **Account Status.** This shows whether the reserve account is current or delinquent according to the required balance less the account balance.

4.12 RESERVE ACCOUNT PRINCIPLES

Reserve account funds are governed by the following principles:

A. Investment Vehicles and Institutions

Reserve account funds not immediately needed to pay for expenses or authorized purposes may be held as set out in this paragraph. Reserve account funds may be held in the form of:

◊ A checking, savings, negotiable order of withdrawal, or similar account at a federally-insured domestic institution, such as a bank, savings and loan, or credit union.

◊ Readily marketable obligations of the U.S. Treasury Department (e.g., U.S. Treasury bonds, U.S. Savings bonds, zero coupon bonds, etc.) at a federally-insured domestic institution or at an insured domestic institution authorized to sell securities.

◊ An account established at an insured domestic institution authorized to sell securities, provided that the accounts meet the remaining conditions set out in this paragraph and are not used in a speculative manner. The account may be a tax-exempt account or a taxable account, and the institution may or may not charge brokerage fees.

B. Limitations on Investments in Securities

Any securities must be:

◊ Backed by the U.S. Government or an Agency of the U.S. Government;

◊ Triple A-rated Government National Mortgage Association (GNMA)-collateralized tax-exempt bonds; or

◊ Triple A-rated pre-refunded bonds.
Pre-refunded bonds are bonds that originally may have been issued as general obligation or revenue bonds but are now secured, until the call date or maturity, by an escrow fund consisting entirely of direct Government obligations that are sufficient for paying the bondholders.

C. Reporting Actual Costs of Securities

To ensure that required amounts have been paid into the reserve account, the actual costs of securities (which in many cases may not be the face value) must be shown on the project books. In addition, details of these transactions should be disclosed in footnotes to financial information provided to the Agency.

1. Security Sales

When the Agency approves withdrawals from the reserve account and the funds are invested in securities, borrowers must, to the extent that securities are available, assure that securities are sold in an amount that results in proceeds sufficient to cover the disbursement.

2. *Forecasting Security Sales*

Since the sale or redemption of any securities may result in cash proceeds of less than the amount invested, borrowers should take steps to minimize the risk of loss from converting securities to cash. Needed reserve account withdrawals should be planned in advance to permit Agency approval of anticipated needs such that security sales can be arranged to be sold in favorable market conditions. When sales of securities take place, the proceeds will normally be held in a reserve fund at a domestic bank, savings and loan, credit union, or similar institution insured by an Agency of the Federal Government until such time as withdrawals are actually needed for the purposes authorized. Should unusual circumstances require the sale of securities in unfavorable market conditions, the borrower will not be required to reimburse the project for any losses incurred.

3. *Knowledge Required of Securities Investors*

Those investing in securities must be knowledgeable of common industry practices prior to investing in securities. Knowledge of the various fees that may be associated with the purchase and sale of securities and the maintenance of security accounts must be considered when making security investments. Examples of these fees are front-end loads of fees, back-end loads of fees, and maintenance fees. These fees may be paid using general operating account or reserve account funds. However, the Agency must give its prior consent before reserve account funds may be used.

4. *Financial Advisor Limitations*

Project proceeds may not be permitted to be used to pay for the services of a financial advisor to assist in the selection of securities for investment, since the securities permitted are relatively limited and must meet the requirements set out in this chapter. However, normal brokerage fees may be paid to secure and sell securities. It is recognized that financial advice may also be provided as part of the normal brokerage fee.

4.13 USE OF THE RESERVE ACCOUNT

A. Planned Use of Reserve Funds

The borrower will request approval for use of the reserve funds using *Form RD 3560-12, Request for Authorization to Withdraw Reserve Funds,* before funds are needed if items were not included on the approved capital budget. The borrower will request withdrawal from the reserve fund using Form RD 3560-12. Annual budgets are to include realistic routine income and expense levels to avoid the need to use reserve funds for routine expenses (operating shortfalls) not

caused by emergencies or very unusual servicing situations. The Agency expects borrowers to anticipate and plan for major capital expenditures at least annually, including a careful review of any approved CNA. Loan Servicers will monitor planned capital needs and expenditures to determine if revisions will be necessary and document the file accordingly.

The borrower is required to submit an annual capital expenditure budget as part of the annual budget submission. The budget should include plans to catch up with any maintenance expenses deferred from previous years, correct any deficiencies identified during Agency site visits, complete capital repairs and replacements scheduled in the project's approved CNA, and/or make necessary modifications to remove physical barriers as identified in a Transition Plan. A cost analysis provides data on projected useful life of materials, common replacement and repair schedules. Independent resources of information such as insurance actuary tables, FANNIE MAE Physical Needs Assessment Guidance to the Property Evaluator or Agency documentation should be consulted for common costs and repair/replacements schedules.

When a reserve account and contributions to the reserve account have been sized in accordance with a fully acceptable capital needs assessment, the reserve account funds are to be used to fund capital items as described in the plan. Since under a capital needs assessment, funding of the reserve is designed to match the timing and amount of needs, following the plan should limit the amount of funds required from operating sources to pay for capital needs.

B. Authorized Uses/Eligible Expenditures

Items usually considered as eligible for draws from the reserve account include capital items such as, but not limited to, the following:

- Making improvements to the housing project without creating new living units, or to retrofit units to make them accessible to the physically handicapped. This is not meant to limit the use of reserve account funds to meet handicapped accessibility needs required to make reasonable accommodations for persons with a disability who apply for housing.

- To address the capital requirements identified by the borrower's Transition Plan and other servicing tools. Loan funds may also be used for this purpose.

- Making permanent improvements to the housing project, such as installing an energy-conserving heat pump.

- For other purposes desired by the borrower, which in the judgment of the Agency will promote the loan purposes; strengthen the security of the loan; or facilitate, improve, or maintain the project and the payment of the loan without jeopardizing the loan or impairing the adequacy of the security.

- Facilitating payment of fees associated with the buying or selling of securities or maintaining a securities account.

- Meet loan obligations of the project in the event the amount available for debt service is not sufficient for the payments.

- Meet an emergency shortfall in operating expenses when the emergency is beyond the control of the borrower and threatens life, or the safety or the physical security of the project. Examples include an extreme weather disaster or reductions in rental income caused by changes in the rental market that affect other housing projects in the market as well. In cases of weather disasters, the project insurance coverage will be reviewed to determine if funding from insurance will be available for repairs. Suitable justification as to why the general operating account is insufficient is required.

- With Agency approval, borrowers operating on a for-profit or a limited-profit basis may make an annual withdrawal from the reserve account equal to no more than 25 percent of the interest earned on the reserve account during the prior year. The borrower will use *Form RD 3560-12 to* request the withdrawal and must provide documentation of the prior year interest earned. For example, in the report submitted for the period January 1, 20X9 through December 31, 20X9, the owner is entitled to 25 percent of the interest earned during calendar year 20X9. The borrower is not entitled to interest earnings from prior years.

- Other items considered eligible for draws from the reserve account include capital items listed in Attachment 4-A, Capital Expenditures.

C. Unanticipated Uses of Reserves

The Agency recognizes that not all capital expenditures can be predicted a year in advance. Sometimes a major piece of equipment will break down unexpectedly or a severe storm will create damage. Borrowers must seek Agency approval for the unforeseen use of reserves. In emergency situations when the borrower can demonstrate an imminent and serious threat to the health, safety, or physical security of the project, the borrower may request the Agency to post-approve the use of reserves. The Agency will only approve emergency withdrawals if the reserves are used for eligible expenses. If post-approval is requested, the bidding requirements, as described below, still apply. If the bid is obtained post-approval and is less than the expense, the difference will be reimbursed to the account by the borrower. Unforeseen circumstances may alter the approved CNA schedule adversely and require further review and modification to meet the reserve deposit schedule in the borrower's loan agreement /resolution. Loan Servicers will

review any loan, transfer or servicing conditions that may be impacted and develop a plan to reflect any modified schedule of findings or repairs.

D. Withdrawal Approval Process

- The borrower must submit a written request, on *Form RD 3560-12*, "Request for Authorization to Withdraw Reserve Funds", to the Agency to withdraw reserve funds, even if the Agency has reviewed and approved the capital expenditures in its review of the annual capital budget.

- The Loan Servicer will take prompt action on a request for reserve withdrawal, normally within 5 working days of receipt of the request, and provide written authorization to the borrower, on *Form RD 3560-12,* for any authorized withdrawal of funds before the borrower actually withdraws any funds.

- When the Depository Agreement has been updated to allow, upon receipt of authorization to use reserve funds, the borrower may use electronic transfer of reserve funds. It is acceptable for the approved withdrawal to be run through the general operating account.

- Borrowers will notify the Loan Servicer of work completed within 5 days so that needed inspections may occur.

- Borrowers will submit a final invoice that describes the specific service and banking transaction if the amount is different than initially approved or was a preapproved capital budget item.

- Borrowers must maintain records documenting all expenses that were paid by withdrawals from the reserve account.

1. Bid Requirements

Expenditures of $5,000 or less do not require bids, even if it is an identity-of-interest (IOI) entity.

The expenditure of reserve funds for a project (all work included in one contract) estimated to cost *more than* $5,000 will require a minimum of two bids. When there is an IOI between the borrower or property manager and a bidder a minimum of three bids must be submitted. The entity with the IOI must submit its bid directly to the Servicing Office prior to requesting bids

from other firms. Once the bids are received the borrower will submit the request using Form RD 3560-12 to the servicing office with all bids attached. An explanation of why the borrower was unable to obtain two non-IOI bids must be provided when appropriate

.2. *Projects Involving Moderate Levels of Construction*

If construction does not involve substantial changes to structures or replacement of major systems, e.g. electrical, plumbing, heating, or cooling, the housing project is considered to involve moderate levels of construction. Examples include exterior repainting, roof repair, parking lot repaving, and repairs to plumbing or electrical systems.

When the borrower requests access to reserves for a moderate construction activity, the Agency first reviews the project documents for acceptance, and then reviews a payment request.
In addition to the items for bids specified above, the borrower must provide the following:

- Project planning documents that describe the work to be performed;
- Copies of written bids; and
- A copy of the contract/proposal.

After the project has been completed, the borrower notifies the Loan Servicer with actual invoice/cost. The Loan Servicer will perform an inspection of the work done to assure it has been completed in accordance with the contract/agreement or statement of work if applicable.

3. *Project Involving Large Levels of Construction*

A project with large levels of construction involves substantial changes to the structure, replacement of major systems, and/or expenditures estimated in excess of $100,000. Such activities are subject to the design requirements of

Exhibit K of RD Instructions 1924-A and 1924-C. In addition to the items for bids specified above, the borrower must provide:

- Project planning documents, including specifications and drawings as necessary to fully describe the work;
- Copies of written bids;
- A rationale for awarding the contract; and
- A copy of the construction contract.

The required planning documents may be prepared by any individual or firm meeting the qualification requirements of the local building jurisdiction. After the planning documents and construction contract have been accepted by the Agency, the borrower may request an initial draw to pay for materials or make a down payment to the contractor. The request for an initial draw should be accompanied by an invoice and a check made out to the contractor or vendor, to be cosigned by the Agency. The Agency may approve such a request provided the amount of the initial draw does not exceed a reasonable percentage of the value of the construction contract. Refer to RD instruction 1924-A.

The Agency will inspect the project before approving the work and again at construction completion before approving the final payment.

- The purpose of the initial inspection is to establish that the proposed work is needed and is an appropriate response to existing conditions.
- The purpose of the final inspection is to establish that the work was performed as described in the Agency-accepted documents.

The Agency may conduct additional inspections as necessary.

The borrower should be required to hire an independent third-party inspector to verify that the work complies with all applicable requirements. To verify that all major systems are adequate, State-licensed inspectors must certify that the dwelling has been inspected and meets Agency standards. When a State does not have licensed inspectors, a qualified, independent, third-party inspector may provide these certifications.

SECTION 4: PROJECT BUDGETS

4.14 BUDGET REQUIREMENTS *[7 CFR 3560.205 and 3560.303]*

A. General Information

Project budgets are planning documents that provide a picture of a project's financial operations for the coming year. They reflect:

- Expected revenues and expenses;
- Plans for maintenance, capital improvements, and reserve account activity;
- Return on the owner's investment, or a Non-Profit Asset Management Fee;
- Establish rents; and
- Reasonable and customary costs to cover turnover costs and maintenance which should be in line with comparable properties in the market.

For projects with 8 units or more, all borrowers will be required to submit project budgets through the Management Agent Interactive Network (MINC). The Agency may make an exception to this requirement if the borrower submits documentation that the costs associated with electronic submission of project budgets would pose a financial hardship to the project. Borrowers must submit annual project budgets to the Agency for approval. Budgets must meet the following requirements:

- Budgets must be reasonable and realistic. Revenues, vacancies and expenses must be consistent with past project budgets, historical actuals and comparable projects. Any differences must be due to legitimate operating needs of the project.
- Project expenses will include only expenses necessary to maintain successful projects. An example of an unnecessary expense is owner or manager entertainment expenses. Project expenses cannot be used for unearned personal benefit or gain, or for reimbursement of false or inaccurate expenses.
- The priority order of project expenditures must be:
    - Senior Position lien holder, if any;
    - Operating and maintenance expenses, including taxes and insurance;
    - Debt service to the Agency;
    - Reserve account deposits;

- Other authorized expenses; and

- Return on the owner's investment or Non-Profit Asset Management Fee.

B. Sections of the Project Budget (*Form RD 3560-7*)

The *Form RD 3560-7* is used to plan and report the financial activity of a multiple family housing project as required by Agency regulations. Refer to the Forms Manual Insert (FMI) for this form and for a detailed explanation of each line item on the budget. The form is divided in 6 parts as described below:

1. Part I - Cash Flow Statement

For budgeting purposes, the cash flow statement projects whether the property will generate enough revenues for all cash needs for the budget period. The proposed budget ending balance must be a positive cash balance and not cause an unwarranted rent increase, nor should it exceed the total of: (1) approximately 20 percent of Total O&M Expenses (Part I, line 16); (2) the amount held for taxes and insurance; (3) any initial operating capital during the first 7 years or until it is withdrawn, whichever comes first. Accrual method accounting will be considered with the annual financial reports and is discussed in Section 5 of this chapter.

- The borrower must not include expenses for purposes unrelated to the housing project or for fines, penalties, and legal fees in the event the borrower has been found guilty of violating laws such as civil rights, evictions, and building codes.

- The borrower is responsible for submitting project budgets that address the project's physical accessibility needs. The Loan Servicer may approve the cost of providing accessible rental housing as an authorized use of project funds.

- The borrower must not include organizational expenses among project expenses. These items are covered by the management fee. (For a list of the bundle of services covered in the management fee, see Chapter 3, Attachment 3-D, and 7 CFR 3560.102.)

  A vacancy and contingency allowance is calculated from the previous 3 years' historical vacancy rate of the property, and should not exceed the caps as identified below. If the historical vacancy rate is greater than established caps, the vacancy and contingency allowance is capped at the following levels:

  ◊ For projects with 15 or fewer units, the vacancy and contingency allowance is capped at 15 percent.

- ◊ For projects with more than 15 units, the vacancy and contingency allowance is capped at 10 percent.

- ◊ When historical vacancy rates exceed the caps, a budget may be approved with the historical rates only after a feasible workout plan has been submitted and approved.

- A Non-Profit Asset Management Fee may be requested by non-profits and cooperatives. Non-profit owners are entitled up to $7,500 per project for certain organizational expenses, such as Errors and Omissions insurance and actual expenses prorated by the number of Rural Development units. Expense reimbursement may not be duplicated on multiple properties. Evidence of expenses is necessary to support the budgeted amount. Examples of acceptable documentation for this expense would be:

  - ◊ A copy of the Errors and Omissions Insurance policy that reflects who is covered and the cost;

  - ◊ Documentation of hours, number of meetings, and the hourly wage rate used for Board of Director's review.

  - ◊ The oversight functions include:

    - ▪ Board of Director's review and approval of proposed budgets, including proposed repairs, outlays, and accruals;

    - ▪ Review of capital expenditures;

    - ▪ Approval of annual financial reports and considerations of any management comments noted; and

    - ▪ Long-term asset management reviews.

Any investor asset management fee, investor service fee, or similar fee may be paid solely from the annual Return to Owner and may not be paid from project operating funds. This is not the same as the Non-Profit Asset Management Fee.

Part II - Operating and Maintenance Expense Schedule

- Operating and Maintenance Expenses entered in this section are broken down as indicated on the appropriate lines according to the following categories:

- Operating and Maintenance include items such as maintenance payroll, painting, snow removal, and grounds. Borrowers should include expected unit turnover expenses, based on the properties historic turnover rate, in

the operating budget. Turnover expenses, such as the replacement of a refrigerator, scheduled unit carpet cleaning, curtain or flooring cleaning or replacement, painting, etc. should be treated as a normal operating occurrence and do not represent a reserve account need. If the unit sustains damages beyond reasonable wear and tear, then an exception may be warranted, as the costs may be abnormal. This is not the typical situation. If an item is budgeted in the annual operating budget as an operating expense, the item must be paid for out of the operating budget, unless it is a circumstance beyond the borrower's control.

- Utilities include only utilities paid by the project. Utilities paid by the tenant are not included on this form. Administrative expenses are project expenses only and do not include expenses that a management firm incurs. The management fee and the services performed for the fee are defined in the 7CFR 3560.102 (i)(1) , Management Certification and or Management Agreement. The Management Plan establishes the systems and procedures that will be employed on site to ensure that project operations comply with Agency requirements.

- Taxes and Insurance expenses include all project insurance and real estate taxes, or any special assessments or other taxes allowed.

2. *Part III - Account Budgeting/Status*

This section of the budget reflects the projected reserve account. The balances of the other accounts are not completed for budgeting purposes, only when actuals are received.

The Loan Servicer must review the reserve account levels and contributions to ensure that they are consistent with the loan agreement. The review focuses on four items:

◊ **Beginning balance.** The Loan Servicer should review the beginning balance of the reserve account to ensure accuracy.

◊ **Transfers to reserves.** The Loan Servicer should examine the budget to ensure that the appropriate dollar amount, as specified in the loan agreement/loan resolution, is budgeted for deposit in the reserve account.

◊ **Transfers from reserves.** Any transfers from the reserve account that are included in the budget should be described in the budget narrative and justified by the capital plan.

◊ **Ending balance.** The ending reserve account balance is calculated by taking the beginning balance, adding the transfers to the reserve account, and subtracting the transfers from the reserve account.

If the Loan Servicer finds that the reserve account level is not where it is supposed to be, that the budget does not show correct contributions to reserves, or that transfers from reserves are not adequately documented, then the borrower must submit corrected budget documents.

3. *Part IV - Rent Schedule and Utility Allowance*

The rent schedule documents the rent and utility allowance structure, and establishes the Rental Income entered in *Form RD 3560-7*, Part I, Line 1.

◊ The Basic Rent is the level required to cover all uses of cash and the repayment of the Rural Development loan at the interest credit reduced payment.

◊ The Note Rate rent is the level required to cover all uses of cash and the repayment of the Rural Development loan at the unsubsidized or promissory note rate.

When tenants pay some or all of their utility costs themselves, borrowers must establish a utility allowance to determine the amount tenants pay toward rent. The utility allowance is deducted from the total shelter cost calculated for the tenant, and the difference is paid by the tenant as rent. If the tenant is entitled to a utility reimbursement, management companies may issue a joint check payable to the tenant and utility company, if they choose.

4. *Part V- Annual Capital Budget*

The capital budget portion of Form RD 3560-7, Part V provides information on plans for capital improvements. It lists all the capital items in the project and provides space for the borrower to indicate their condition, address transition plan items and any needed improvements. The Annual Capital Budget allows capital items to either be expensed from operations or capitalized from the reserve.

The borrower identifies major maintenance, replacement and accessibility needs during the annual budget cycle and develops a schedule for making withdrawals from the reserve account to pay for their cost. These plans are incorporated by the borrower into the annual capital expenditure budget and may also be reflected in the operating budget if the work is to be paid for out of operating income. Attachment 4-A offers guidance for budgeting capital items. The objective is to help ensure the borrower properly manages reserve account resources and establishes budgets to address the project's capital needs.

If the Loan Servicer finds the operating and capital budgets inadequate to keep the project in compliance with Agency standards for physical conditions *[7 CFR 3560.103]*, the Loan Servicer must request the borrower to modify the annual capital plan. The Loan Servicer may also request modifications if it is found that the borrower has proposed expenditures to be paid from reserves that should be charged to the operating account.

5. *Part VI - Narrative, Signatures, Dates and Comments*

This section of the form will be used to complete the borrower's Budget Narrative, Signatures, Dates and Comments.

Budget Narrative:

The budget narrative provides a description of the budget and highlights important elements to aid Loan Servicers in their review of the budget.

The budget narrative must be completed, or the budget will be considered incomplete and returned for correction.

◊ **Items to Be Covered in a Budget Narrative:**

The following information should be included in the budget narrative.

- A brief description of the project and its status. The description should address key indicators of project status.
- A statement of project compliance. Indicate any outstanding monitoring findings and the progress in addressing the problems.
- An explanation of projected capital expenditures and reserve withdrawals for the upcoming year and capital needs for the next three years.
- A description of the project's overall financial status and important factors contributing to the changes. (Vacancy, workout plan status, debt deferrals, servicing efforts.) If the analysis reveals that the subtotal for any operating expense category (maintenance and operating costs, utilities, administration, or taxes and insurance) exceeds the tolerance threshold, the borrower will provide adequate documentation that the expenses for this category are reasonable and necessary. For example:

  Costs are comparable to the costs for similar properties in the conventional market. In this example, the borrower might show that insurance costs for the same coverage at a conventional project are comparable to the costs for the project shown in the budget.

- The factors contributing to the cost increases are beyond the borrower's control and the borrower is actively implementing cost-containment measures. For example, the project is subject to utility rate or tax increases.

- The cost increase is needed to cover actions to address identified physical deficiencies that are not due to negligence by the borrower or the management agent. Physical deficiencies that are due to negligence by the borrower or the management agent are not acceptable reasons for a rent increase.

- ***Signatures:***

  The budget form requires signatures of the borrower. If the budget has been submitted electronically, a signed copy is not required to be submitted to the Agency. Agency approval may be by letter submitted electronically or by signing and returning form RD 3560-7.

- ***Comments:***

  Borrowers are encouraged to submit additional information detailing sources and uses of cash required. Detailed breakouts should relate to specific line subtotals or total entry as listed on the form. Comments are encouraged to better explain the contents of the submitted budget. Use the comment area if additional disclosures or analyses are necessary. Rural Development Servicing Officials should document additional relevant information, or record issues or concerns noted during review.

C. Borrower Submission Requirements

The borrower should ensure that the project budget meets all the following:

- ***Complete Budget***

  The Budget is considered complete when the borrower has submitted the information listed in Exhibit 4-1.

- ***Changes in Rents***

  It may be necessary for the borrower to request Agency approval to effect a rent change as operating costs and/or revenues in a project fluctuate Exhibit 4-3 shows the timeline for borrower submission and Agency review of rent change requests.

All borrowers, including those using the Department of Housing and Urban Development (HUD) project-based Section 8 contract assistance, must obtain prior Agency approval for a rent increase. Changes in rental rates will apply to all units in a project. Rent change requests for multi-family housing projects with no HUD subsidy are typically submitted and reviewed at the same time the borrower submits an annual budget for approval. Rent changes in HUD project- based Section 8 projects resulting from rent increases by HUD must also be reviewed and are not to be automatically approved. As with any Section 515 project, only the amount of rent necessary to cover project expenses must be approved.

- ***Annual Utility Allowance Reviews***

The borrower should review utility allowances on an annual basis to determine whether any changes need to be made. The borrower should indicate changes or no changes to utility rates in the budget narrative. Setting Utility Allowances:

The utility allowance is based on expected costs for utilities. Once established, the borrower must review the utility allowance annually. This is done in conjunction with the annual budget process. The borrower must submit documentation along with *Form RD 3560-7* to the Field Office using the following procedures:

1. A 12-month average will be used for the calculation.

2. Borrowers must establish utility allowances for each size and type of rental unit in the housing project based on utility costs.

3. Borrowers will request a change to the existing utility allowance if the proposed change is 10 percent or more.

4. A summary of the calculations must be submitted to the Servicing Official along with the *Form RD 3560-7*.

5. The borrower must obtain the following documentation describing the utility allowances and keep in the project files:

    - **Rate Changes:** Documentation of the rate changes may include actual billing information or documentation from utility companies;

    - **Usage:** Documentation of a 12-month sampling of tenant utility usage from the utility company. A sampling will be dependent on the size of the project and will include every size of unit. If tenant utility information is unavailable from the utility company or only provided at cost, utility billings received by tenants are acceptable**.**

- **No Changes:** Documentation of no change in utility rates has occurred during the period being reviewed. A public release from the utility provider indicating no change in rates has occurred during the period reviewed is acceptable. The borrower should indicate no changes to utility rates in the budget narrative.

- ***Tenant Notification and Comments***

  At the same time the borrower submits the initial Notice to the Agency that it intends to submit a rent or utility allowance change request, the borrower will send or deliver notices to each tenant in the project notifying them of the rent change request that will be submitted to the Agency with their annual budget. *Handbook Letter 203(3560)* provides an example of such a Notice. The borrower must also post this Notice in a common area frequented by the tenants, such as the laundry room or near the mailboxes.

  The Notice must inform the tenants that they have 20 calendar days to provide their comments to the Agency. If during this time the Agency receives any tenant comments, these must be immediately forwarded to the borrower with the identity of the tenant protected. This can be done by either paraphrasing the comments for the borrower or by removing any identifying information from the correspondence received from the tenant before forwarding it on to the borrower. The Agency will respond to the tenant that their comments will be considered in the review of the budget. Upon conclusion of the 20-day comment period, the Agency must notify the borrower of approval or denial within 10 days.

Exhibit 4-1 Information required for a complete Budget Submission reflects information the borrower is required to submit on the annual budget for the project.

Exhibit 4-1
Information Required for Budget Submission to be Complete

1. *Form RD 3560-7* must be used to reflect the project's financial needs for the year and thereby rental charge requirements. A new operating budget for the fiscal year must include:

- Proposed budget at proposed rents
- Operating and Maintenance Expense Schedule
- Rent Schedule and Utility Allowance
- Annual Capital budget
- Narrative explaining
  - Project statusProject compliance
  - Rent and utility allowance change justification
  - Projected capital expenditures and reserve withdrawals
  - Outstanding findings
  - Servicing effort status (Work out plan / other debt)
  - Project financial accountability and concerns
  - Account status (T&I, GOA, Reserve)
  - Any unique situations

2. *Utility allowance review.* Required documentation for utility costs as described earlier in this Chapter and Chapter 7.

3. *HB Letter 203(3560)* Notice to Tenants (Members) Of Proposed Rent (Occupancy Change) And Utility Allowance Change (if applicable).

4. *Other information*. Any other information the borrower believes is necessary to justify the proposed rent and/or utility allowance change request.

- ***Documentation***

The borrower must fully document any rent and utility allowance change request. Requests for a rental charge change must be based on a realistic projected budget for the interim year or the ensuing full year. The borrower must provide to the Agency the information identified in Exhibit 4-1 with the rent or utility allowance change request.

The narrative attached to the budget form must clearly explain the necessity for the change request, and the Loan Servicer must analyze the supporting documentation to the budget *Form RD 3560-7,* to see if it supports the request. For example, if the rent increase is due to increased taxes, then the Loan Servicer should look for copies of tax increase notices in the budget documentation. If the rent increase is due to an increase in general operating expenses, the Loan Servicer must review those expenses for reasonableness.

- ***Late Budget Submissions***

  The schedule provided for budget reviews relies on timely submission of budget documents by the borrower. If the borrower is tardy in submitting required documents, the Agency cannot ensure that all deadlines will be met. Therefore, if a borrower submits the budget late, Agency deadlines no longer apply, and the borrower is not eligible for "automatic approval" of the budget (as discussed in Paragraph 4.14 D of this chapter). If no budget is approved by the end of the project's fiscal year, the borrower must operate under the previously approved budget (referred to as a Carry-Over budget) until the Agency reviews and approves the new budget.

- ***Carry-Over Budgets***

  If a budget for the new fiscal year is not entered in MFIS before the first day of the fiscal year, a Carry-Over budget is automatically built from the prior year budget on the first day of the project's fiscal year by MFIS. This is necessary as the borrower has not presented an acceptable budget in time to be effective on the first day of the project's fiscal year and is, therefore, operating under the current existing budget, which would then become the Carry-Over budget.

  When an acceptable budget is received, after the beginning of the fiscal year, a Mid-Year Budget will need to be completed.

- ***Mid-Year Budgets***

  A Mid-Year Budget is a budget that has an effective date other than the first day of the project's fiscal year. This type of budget should be used if there is a change in rents or utilities on the project after the current budget has been approved. It should include operating income and expenses that would be expected for the next 12 months after the effective date of the budget.

MFIS will prorate the budget correctly for analysis. The Mid-Year Budget will need to be added to MFIS with the new effective date. This process would also be used for transfers to establish the first budget.

A Mid-Year Budget may also be needed if the regular annual budget was not submitted and approved prior to the first day of the project's fiscal year and a Carry-Over budget went into effect.

Exhibit 4-2 Timeline Example for Carry-Over and Mid-Year Budgets provides an example of the timelines for Carry-Over and Mid-Year budgets and updates in MFIS.

Exhibit 4-2
Timeline Example for Carry-Over and Mid-Year Budgets

1. No budget was received by 1-1-XXXX	MFIS creates a Carry-Over budget using a 1-1-XXXX approved date.
2. Budget received 2-10-XX with rent change effective 6-1-XX	Create new budget in MFIS (Mid-Year budget) with effective date of 6-1-XXXX

Exhibit 4-3 Schedule for Budget Submission and Review provides the timeframes for project budget submission and its review by Loan Servicers.

Exhibit 4-3
Schedule for Budget Submission and Review

Budgets Without Rent Change	
60 calendar days prior to end of the project's fiscal year *November 1**	Borrower submits all necessary budget documents to Agency. Within 30 calendar days of transmitted, the Agency must take action by approval or denial of the budget or contact the Borrower to request additional information or clarification.
30 calendar days prior to end of fiscal year *December 1*	Agency approves or denies the budget.** • If the budget was unacceptable, the borrower may submit additional information to address deficiencies within 10 calendar days. • Agency makes final approval or denial of budget within 20 calendar days of receipt of this additional information.
End of fiscal year *December 31*	Final approval or denial of the budget. If budget is denied, the current year's budget remains in effect.
Budgets With Rent Change	
90 calendar days prior to end of fiscal year *October 1**	Borrower notifies tenants of requested rent change *(Handbook Letter 203(3560)* and submits all necessary budget documents to Agency. • Tenants have 20 calendar day comment period to provide comments to Agency. • Within 30 calendar days of transmitted, the Agency must take action by approval or denial of the budget or contact the Borrower to request additional information or clarification. If no action is taken and the rent increase is $25 or less, it may be considered automatically approved.
60 calendar days prior to end of fiscal year *November 1*	Agency provides notice to the borrower of budget approval or denial.** • If the budget was unacceptable, the borrower may submit additional information to address deficiencies within 10 calendar days. • Agency has 20 calendar days to review the additional information.
30 calendar days prior to end of fiscal year *December 1*	Agency gives final approval or denial of the budget. • If the budget is approved, tenants must have at least 30-calendar days' notice (*Handbook Letter 204(3560*) or notification required by local law before the rent increase takes effect. If notices given to tenants at the outset stated the correct amount of the effective increase, then the 30-calendar day notice has been given. • If the rent increase is denied, the borrower may submit a revised budget at previously approved rents with expenditures acceptable to the Agency. In the absence of such a revised budget, the current year's budget remains in effect. • Tenants will receive Handbook letter 204 (3560) notifying of RD approval or denial of the rent change
Beginning of project's fiscal year *January 1*	New budget and rent increase take effect.

* The dates provided are for a sample project with a fiscal year that begins January 1. For projects with different fiscal years, adjust accordingly.

** If the borrower submitted the budget on time and has not been notified by the Agency of any deficiencies by this time, the budget is considered approved unless it is not eligible for automatic approval.

D. Agency Review Requirements

Loan Servicers must take the steps shown in Exhibit 4-4, Steps in the Budget Review and Approval Process, when reviewing and approving budgets.

Exhibit 4-4

Steps in the Budget Review and Approval Process

- Follow procedure for receipt of budgets;
- Prioritize budgets for review;
- Review outstanding monitoring findings;
- Review the budget for reasonableness;
- Review the rent change, if requested; and
- Approve or deny the budget.
- Update MFIS

Budgets for projects that receive HUD project-based Section 8 assistance need to be reviewed with the same rigor as other projects. However, there are certain procedures that differ. These procedures are discussed later in the chapter.

1. Receiving the Budget

Standard procedures for budget receipt will help Loan Servicers track the progress of budgets through the approval process and meet approval deadlines. Further, intake procedures should help prioritize the review of budgets so that those with the highest priority (e.g., those with rent changes) receive the attention they need in a timely manner.

The following steps are taken upon receipt of budget submissions:

- When hard copies of the budget are submitted, the documents should be date stamped, entered into MFIS (complete transmitted date and input the financial details), and forwarded to the appropriate Servicing Official for review.

- When budgets are transmitted through MINC, the Loan Servicer will find the budget under Industry Interface in MFIS. If the budget transmission is accepted, the system will complete the transmitted date for this item. The following items are needed for the budget to be accepted by the MFIS system:

  ◊ Effective day must be 1st of the month.

  ◊ Effective day must be within fiscal year range.

  ◊ The budget cannot be in approved status.

◊ The type of units identified in the rent schedule submitted must match the units identified in MFIS and must support all project units.

◊ Budget line items identified as 'Other' must contain a supporting detailed comment.

- Within 30 calendar days of transmitted, the Agency must take action by approval or denial of the budget or contact the Borrower to request additional information or clarification. Refer to Exhibit 4-1 for complete budget requirements.

- If the budget submission is complete, the Loan Servicer will input the receive date in MFIS and the budget review should continue as described in the following sections. If the budget is incomplete, the Loan Servicer must take the steps described below.

- Incomplete Budgets
  If any items are missing or are of such poor quality that there is insufficient information to begin an assessment of the budget, the budget is considered incomplete.
  If the budget submission is incomplete, the Loan Servicer must contact the borrower in writing, stating that the budget is incomplete, and discuss the deficiencies.

  ◊ If the borrower submits the information within 10 days, the budget is considered to be on time, and the review can still be completed prior to the end of the fiscal year. The budget is eligible for automatic approval, as described later in this chapter.

  ◊ If the borrower does not submit the requested information within a 10-day time period from the Agency's contact, the Agency cannot guarantee approval of the budget before the beginning of the new fiscal year. In these cases, the borrower must continue operations under the previous year's budget until a budget is approved. The borrower is not eligible for automatic approval as described in Paragraph 4.14 D, and the budget will be returned unapproved.

  ◊ A Notice should be sent to the borrower when it is determined the budget is past the deadlines set by the Agency.

Agency Review Time

The total Agency review time for a budget from submission to initial approval or denial is 30 calendar days for budgets with or without rent increases
If the initial budget is denied, this schedule allows for a second review of the budget and approval (if appropriate) before the start of the fiscal year. However, the Agency must take final action on all budgets within 60 calendar days of receipt of the borrower's budget.

2. Prioritizing Budgets for Review

After budgets have been received and determined to be complete, the Loan Servicer should prioritize budgets for review. Prioritizing the budgets helps to ensure that the budgets that require the most thorough review receive the attention they need. Budgets with the highest priority for review include budgets for projects with:

- Requests for rent increases above $25/month;
- Vacancy rates above the allowable threshold; and
- Past monitoring findings.

While Loan Servicers should place the highest priority on reviewing these budgets, they should plan their time to allow for sufficient review of all budgets.

3. Reviewing Outstanding Monitoring Findings

Having determined that the budget submission is complete, the Loan Servicer must check the project for outstanding monitoring findings and assess whether the borrower's budget reflects adequate efforts to address these findings.

- If the outstanding monitoring issues have been adequately addressed in the budget, the Loan Servicer should proceed with the review for reasonableness.
- If project compliance issues have not been addressed, the budget documents should be returned to the borrower for revision.

4. Review the Budget for Reasonableness

If all outstanding compliance issues have been addressed, the Loan Servicer must review the budget for reasonableness using the steps outlined in Attachment 4-D Budget and Year End Analysis, to make a determination. These review items are automated in the MFIS budget analysis process. Attachment 4-D shows the items included in the analysis and how they are calculated

- Review Form RD 3560-7 to verify that all appropriate line items are completed. Perform a quick assessment to ensure that they appear to be completed properly.

- Complete the budget analysis which is required prior to entering an "Approved" date in the Supervisory Activity of MFIS. The analysis will reflect areas of observations and review items which will require comments. Just because an item is brought out as an observation or review does not necessarily mean the budget cannot be approved.

  - ◊ Observations are the results of a test performed that may be of importance to the loan servicer.

  - ◊ Review items are the results of a test performed that require comments as documentation of the review.

  - ◊ Ratio analyses are reflected in the Budget Analysis in MFIS and are an effective tool for financial analysis. They prescribe various measures of actual operating performance. The Loan Servicer should become familiar with these percentages as a comparative analysis and consider utilizing the Hyperion MFH Budget Line Item Comparative Cost data report for their Region in their analysis. The ratios ran in the MFIS Analysis Review are described in Attachment 4-D.

  - ◊ Norms are also reviewed on the Budget Analysis. The Norms are based on Regional Groupings of "like" properties. This gives the Servicer an analysis of how the property is performing compared to other "like" properties. The norm definitions are described in Attachment 4-D.

- Determine whether the ending cash balance exceeds the permissible limit. If it does, the surplus must be contributed to reserves to address capital needs, be deposited in the project's reserve account, or applied to the loan balance to reduce the debt service on the borrower's loan. Based on the surplus, the Agency may require a rent decrease.

- Verify that the capital budget is complete. Capital improvements including implementing a borrower's transition plan, and Capital Needs Assessment (CNA) should be included as part of the capital budget portion of Form RD 3560-7 when applicable. Compliance-related costs include reasonable fees and costs for preparing self-evaluations and transition plans.

- Annual Capital Expenditure Budget

  The Loan Servicer uses the budget cycle to assess the borrower's annual capital expenditure budget compared with available information about the types of capital improvements needed to maintain the project's physical condition. Independent sources of information such as insurance actuary tables, FANNIE MAE Physical Needs Assessment Guidance to the Property Evaluator or Agency documentation should be consulted for common costs and repair/replacements schedules.

  The Loan Servicer reviews the operating and annual capital budgets, and compares them with previous budgets, site visit reports, physical inspections, capital needs assessments, and audit reports. When doing so, the Loan Servicer should consider the following questions:

  ◊ Are expenditures sufficient to maintain the project according to the Agency's performance standards and the requirements of the project management plan?

  ◊ Were any essential items of maintenance deferred during the past year, which should be financed from the upcoming operating or capital budget?

  ◊ Are there any uncorrected defects noted in site visit reports that should be financed from the upcoming operating or capital budget?

  ◊ Has a CNA of the property been prepared? Does the budget match the prepared CNA?

  ◊ Is the amount budgeted for maintenance and replacement reserve expenditures sufficient to address immediate capital needs?

  ◊ If capital needs information is available from a prepared CNA, are replacement reserve contributions and funding levels sufficient to address anticipated capital needs over the next 5 years? Does the CNA need to be updated?

5. Review the of Rent Change Requests

When the borrower submits a budget with a rent or utility allowance change request, the Agency must respond to the borrower within 30 calendar days of submission. If the Agency does not contact the borrower, the borrower may assume that any rent change request of $25 per month or less has been automatically approved.

Even if the Loan Servicer has determined that the budget is reasonable based on the tests outlined in Attachment 4-D, the rent increase must still be reviewed to confirm that the rent/utility allowance change will not adversely affect the marketability of the units and create a vacancy problem. If a review of the rent increase shows that the rent increase will adversely affect the marketability of units, the full rent increase cannot be approved. The borrower should seek a reduced rent increase and, if appropriate, request a servicing action that will enable the project to achieve a positive cash flow at lower rents. The Agency will not consider rent increases based solely on guaranteeing that the borrower will receive a Return at the end of the project's fiscal year.

a. Circumstances in which the Agency Will Not Approve a Rent Increase

The Loan Servicer must not approve a rent increase under the following circumstances:

- The borrower is able but unwilling to comply with program requirements. Such a borrower has ignored repeated requests from the Loan Servicer to take servicing actions by a specified deadline.

- If the borrower is in default of the Agency loan agreement and does not have an Agency-approved workout plan or is not in compliance with an Agency-approved workout plan.

- There are sufficient project funds under the existing rents to meet project operating expenses, and the borrower is not able to justify the higher rents. Such a condition is established when the project budget shows that income meets expenses at current rent levels.

- The project is operated on a for-profit basis, and the rent change would result in rents higher than what tenants can afford. This condition is established by comparing rents with 30 percent of tenant-adjusted incomes. If it is shown that tenants would be paying in excess of 30 percent of their adjusted incomes with new rents and the increase is not necessary to meet projected costs, then the increase must not be approved.

Addressing Rent Increases

Loan Servicers must make every effort to review budgets with significant rent increases within the time limits. Postponing approval is not an acceptable way to address rent increases.

b. Denial of Rent Change Requests

If the Loan Servicer denies the change request, the borrower must be notified of the denial and be provided with appeal rights. (See Chapter 1)

c. ***Effective Dates of Change***

The effective dates of any approved changes will coincide with the start of the project's fiscal year or the start of the season for labor-housing projects. For a rent/utility change request on which comments were solicited and the amounts were increased from the original Notice, the borrower must deliver a notice to tenants, using Handbook Letter 204 (3560), announcing the rent or utility allowance increase to be effective 30 calendar days (or in accordance with local regulations) from the date of the notification. If the rent/utility increase will be the same as what was stated in the initial notice to the tenants, the initial notice then serves the purpose of "the Notice". HB Letter 204 (3560) will be sent to notify tenants of RD decision to approve.

If the rent/utility change figure from the original notice is revised downward, the borrower must notify the tenants of their new rents prior to the first day of the month in which the new rent amounts are due. However, the borrower does not have to give a 30-day notice of the new rents in this case.

For notices to tenants, see Appendix 4.

d. ***Rent Change Requests Under Special Circumstances (Mid-Year Budgets)***

The Loan Servicer may accept borrower requests for rent or utility allowance changes at times other than with the annual budget

submission. Under special circumstances if a change is necessary to preserve the financial integrity of a project and the financial distress is due to circumstances beyond a borrower's control, a change request may be considered. Such circumstances might be in the event of a natural disaster, property transfer or when workout procedures and servicing actions are necessary.

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a Special Note Rent (SNR) that is less than Note Rent but higher than Basic Rent, to attract or retain tenants whose income level would require them to pay the SNR. The requirements for receiving an SNR are established in Chapter 10 of HB-3-3560.

Both of these situations would require a Mid-Year Budget be submitted to the Agency for approval.

e. Approving Utility Allowances

Agency Staff must review the utility allowance documents submitted with the budget to make sure that the numbers being used are reasonable and comparable to other projects in the same market area. In addition, the Loan Servicer should check project budgets of any other Agency-funded projects in the area to see if utility allowances are similar.

f. Rent Changes for Units Receiving HUD Project-Based Section 8 Assistance [7 CFR 3560.207, and HUD's Section 8 Renewal Policy Guide Book, Chapter 14]

The Agency has the responsibility to review and approve project budgets on an annual basis based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer will not take into account HUD's automatic annual adjustment for Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.

The agreement in the Memorandum of Understanding (MOU) between HUD and Rural Development indicates that the RD-approved budget will be submitted to HUD by the Project Owner and will serve as the basis for the budget-based rent in the contract renewal process. The rents at initial renewal will be determined by the HUD staff, who will compare the RD-approved, budget-based rent as submitted by the Project Owner to the current rents adjusted by an Operating Cost Adjustment Factor (OCAF) and will set the contract rent at the lesser of the two amounts. HUD staff will then notify both RD and the owner of the new contract rents. Rent adjustment at subsequent renewals will be determined by OCAF unless the owner requests and HUD approves a budget-based increase that has been approved by RD.

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have a 3-column budget in properties with HUD project-based Section 8 contracts. Exhibit 4-5 Reviewing Budgets with HUD Subsidies depicts how many columns are required in the budget, depending upon the project type.

Exhibit 4-5

Reviewing Budgets with HUD Subsidies

Project Type	Rents Needed In Budget
• **Section 8/Section 515 without interest credit**.	• Note Rate Rent (HUD contract rent); difference is excess funds and deposited into reserves.
• **Section 8/Section 515 with interest credit**.	• Basic Rent, Note Rate Rent, and HUD contract rent.

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 4-6 Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account, the borrower must deposit the difference between the Agency-approved Note Rate Rent and the higher HUD-authorized rate into the reserve account. The manager or borrower must use *Form RD 3560-29*, Notice of Payment Due Report, to document the required deposit in the reserve account. The Loan Servicer will monitor this deposit when reviewing the year-end actuals.

If excess HUD rents accumulate in the reserve account beyond the sum shown in the borrower's loan agreement or resolution, the Loan Servicer may reduce or cancel the interest credit on the project. The Agency may reinstate interest credit whenever HUD rent becomes lower than the Agency Note Rate Rent, determined by the Interest Credit Agreement. Refer to Exhibit 4-5.

Before depositing excess funds in the reserve account, the borrower may have to collect overage. Whether overage is collected, and a project is subject to cancellation of interest credit depends upon the issuance date and execution date of the project's interest credit agreement.

Certain early versions of the Interest Credit Agreement do not have a legal basis to support the Agency's policy to cancel interest credit or collect overage to offset interest credit. Each HUD project-based Section 8/Section 515 project needs to be categorized according to the issuance date and execution date of the project's Interest Credit Agreement on Form FHA 444-7, Interest Credit Agreement or its successor Forms FmHA 444-7, FmHA 1944-7, and RD 3560-9.

Exhibit 4-6 Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account provides a description of the rules that apply to each interest agreement form.

Exhibit 4-6
Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account

Form	Executed Before October 27, 1980	Executed On Or After October 27, 1980
FHA 444-7, dated 11/17/69 and 7/27/72	No basis to cancel or reduce interest credit, collect overage, or deposit excess funds in the reserve account unless the borrower agrees.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 444-7, dated 10/13/77	• If first, second, fourth or fifth block of paragraph 2 checked, no legal basis to cancel or reduce interest credit, collect overage, or deposit excess funds into reserves. • If the third block of paragraph 2 is checked, no legal basis to cancel or reduce interest credit, unless borrower agrees. However, there is legal basis to collect overage and deposit excess funds to reserves and/or apply it on the loan.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 1944-7, dated 11/29/82		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.
FmHA 1944-7, dated 4/85		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.

6. *Approval or Denial of Budgets*

Once the budget analysis is complete, Loan Servicers must notify the borrower whether the budget has been approved or denied.

a. Budget Approval

If a budget is received with reasonable operating expenses and a rent increase request to cover turnover costs and maintenance costs in line with comparable properties, the Agency should not unreasonably withhold approval. In some cases, rents may need to be increased. When market conditions do not allow for sufficient rents to fund both operating and capital needs, the workout authorities of 7 CFR 3560, Paragraph 3560.453 should be reviewed for their applicability in the situation.

If the Loan Servicer has determined that the budget represents reasonable costs and adequately addresses all outstanding compliance issues in the budget, the reserve account is current, and the rent change (if requested) is acceptable, the budget may be approved. To approve the budget, Loan Servicers must acknowledge approval (*Form RD 3560-7*). This acknowledgement may be by letter if the budget was submitted electronically, or by signing, and returning a copy of the form to the borrower with a cover letter. The Loan Servicer must also enter the approval date in MFIS. If the approved rent/utility change is increased from the originally posted change, the borrower must deliver a notice to tenants announcing the rent or utility allowance increase to be effective 30 calendar days (or in accordance with local regulations), from the date of the notification using Handbook Letter 204 (3560).

b. Automatic Budget Approval

Budgets that are not reviewed within the 30-day period are automatically approved unless:

◊ The budget proposes a monthly rent increase above $25/month per unit; or

◊ The budget is submitted late or misses other deadlines set by the Agency.

◊ Vacancy rates are above the allowable threshold.

◊ Property is under a workout plan or debt deferral.

If a budget is not eligible for automatic approval and no decision is made prior to the beginning of the project's new fiscal year, the borrower must continue operations under the previous year's budget. A denied date must be completed in MFIS at this time. In these cases, the Agency must continue to work with the borrower to address the requested increase. When an agreement is reached, a new budget may take effect.

A notice will need to be sent to the borrower when it is determined the budget submission is past the deadline set by the Agency. If no response is received within timeframes established in the Notice, servicing actions will begin using Servicing Letter #1 (HB-3, HB Letter 301 (3560)).

c. Procedure for Automatic Approval

In the case of automatic approval, the Loan Servicer must still acknowledge approval (Form RD 3560-7). This acknowledgement may be by letter if the budget was submitted electronically, or by signing and returning a copy of the form to the borrower with the letter.

d. Budget Denial

If the Loan Servicer denies the proposed budget because it is found to be unacceptable for reasons related to outstanding monitoring findings, cost reasonableness, reserves, or a rent increase, the borrower has an opportunity to address the deficiencies.

◊ The Loan Servicer must return the proposed budget to the borrower with a letter listing deficiencies.

◊ The Loan Servicer must enter the appropriate 'Denied' tracking step in MFIS.

◊ The borrower has 10 calendar days to submit new information to the Agency. The borrower may adjust the size of the rent increase requested or provide new documentation to justify budget items.

◊ The Loan Servicer must review the new submissions within 20 calendar days of receipt, and either approve or deny the budget.

◊ If the budget is approved based on the new submissions, the Loan Servicer must acknowledge approval. Approval may be by letter submitted electronically or by signing and returning a copy of the

form to the borrower. MFIS will be updated by removing the "Denied" step and populating the "Approved" step.

◊ If the budget is denied based on the new submission, the Loan Servicer must send the borrower a letter stating the deficiencies and informing the borrower that the previous year's budget remains in effect. The borrower must be given the option to submit a new budget using the previous year's rent levels but adjusted for projected capital expenditures and other known changes for the coming year. The borrower may appeal the budget denial in accordance with Agency appeal procedures.

SECTION 5: REPORTING AND FINANCIAL EXAMINATION

4.15 MONTHLY AND QUARTERLY REPORTS *[7 CFR 3560.307]*

A. Overview of Reports

Financial reporting provides the Agency and the borrower a means to monitor the project's financial progress.

- **Quarterly Reports.**

  Quarterly reports based on a Borrower's Fiscal Year are required in the following situations:

  - At completion of new construction or substantial rehabilitation;
  - When the project is subject to a workout agreement; and
  - In the case of reamortization and transfer of an existing project loan.

- **Monthly Reports.**

  Loan Servicers may require borrowers to prepare and submit reports on a monthly basis when additional tracking and supervision are needed. For example, when a project is subject to a workout agreement; when there has been a violation of program rules or reporting requirements; or, when the project shows signs of financial distress.

Loan Servicers may notify in writing the borrower to discontinue the monthly reporting requirement for projects that have demonstrated consistent compliance with program requirements over a sufficient time. Generally, 12 months of consistent compliance is considered sufficient to discontinue the reporting requirements.

B. Review of Monthly and Quarterly Reports

The borrower must submit the required reports following the close of the reporting period (quarter or month, as appropriate), and submit them to the Agency by the 20th of the month following the reporting period via the MINC system. Upon receipt, the Loan Servicer must review the analysis report as indicated in Attachment 4-D, and review the following:

◊ Look for red flags such as dramatic changes in income, expenses, the general operating account, or the reserve account.

◊ Check balances in accounts as referenced in Paragraph 4.3 Overview of Accounts in this chapter, to make sure they are consistent with the management plan, loan agreement/resolution, and the budget.

◊ Check project expenditures against the budget. Make sure the project is being operated in accordance with the approved budget.

◊ Check progress against workout agreements. Make sure the borrower is taking any actions indicated in a workout agreement and is abiding by the established schedule for these actions.

4.16 ENGAGEMENTS AND PREPARATION OF ANNUAL FINANCIAL REPORTS [7 CFR 3560.308 and 7 CFR 3560.578]

A. General Requirements for All Borrowers: Annual Financial Reports

To ensure that the project is in sound financial condition and is complying with the program financial management requirements, the Agency requires annual financial reports to be submitted by each borrower.

All borrowers who have a Section 515 Rural Rental Housing (RRH) loan or a Section 514 Off-Farm Labor Housing loan must comply with the financial reporting requirements of this section. The requirements are established based on combined Federal Financial Assistance and risk thresholds for each borrower. Projects with fiscal years ending 12-31-19 and after are to follow the reporting requirements outlined in this Section.

Combined Federal Financial Assistances is defined as a combination of any or all of the following sources:

- Outstanding principal balance and deferred principal balance at the beginning of the fiscal year of a United States Department of Agriculture (USDA) Mortgage, a mortgage insured by the Federal Housing Administration (FHA) or HUD held mortgages and other Government insured loans (Including but not limited to HOME, and CBDG loans);

- Any USDA Rental Assistance or Project based Section 8 assistance received during the fiscal year;

- Interest reduction payments received during the year (interest subsidy);

- Federal grant funds received during the year and/or;

- Outstanding principal balance at the beginning of the fiscal year of an existing USDA Section 538 Guaranteed Rural Rental Housing loan.

Funds the borrower entity receives which must comply with Federal statutes, regulations, or terms and conditions of Federal awards will be included as Federal Financial Assistance.

Exhibit 4-7 Year End Financial Reporting Requirements outlines the financial reporting requirements for specific types of properties.

Exhibit 4-7 Year End Financial Reporting Requirements			
For-Profit or Limited Profit			
Total Borrower Federal Financial Assistance*	Forms RD 3560-7 and 3560-10	Borrower Certification of Performance Standards	Uniform Administrative Requirements Audit required
RD Borrower with **less than $500,000** in Federal financial assistance	Yes	Yes	No
RD Borrower with **$500,000 or greater** in Federal financial assistance	Yes	Yes	Yes**
State and local Governments, Indian tribes and Non-Profit Organizations			
Total Borrower Federal Financial Assistance*	Forms RD 3560-7 and 3560-10	Borrower Certification of Performance Standards	Single Audit in accordance with 2 CFR part 200 subpart F
RD Borrower with **less than $750,000** in Federal financial assistance	Yes	Yes	No
RD Borrower with **$750,000 or greater** in Federal financial assistance	Yes	Yes	Yes***

***See RD Programs Audit Determination Worksheet and Major Program Determination – Attachment 4-G**. Compilation of Prescribed Forms may be necessary, if an audited financial statement is not required by another federal agency or other business agreement,

**Must be completed by an Independent CPA.

***In accordance with the Council of Financial Assistance Reform (CoFAR) uniform guidance. This Single Audit is in accordance with 2 CFR part 200 subpart F, Appendix XI Compliance Supplement; and submitted to the Agency as part of the financial reporting requirements. Must be completed by an Independent CPA.

Borrowers will be required to submit Forms RD 3560-7 and 3560-10 electronically through MINC. The Agency may make an exception to these requirements if the borrower submits documentation that the costs associated with electronic submission would pose a financial hardship to the project.

Borrowers with fewer than 8 units may submit hard copies to the Agency within 90 calendar days of the project's fiscal year end.

B. Budget Actuals and Balance Sheet

Year-end reporting requirements include the use of Forms RD 3560-7, *Multiple Family Housing Project Budget/Utility Allowance Budget Actuals* and Form RD 3560-10, *MFH Borrower Balance Sheet*.

- *Form RD 3560-7* is used for end-of-year reporting using actual income and expenses.

- *Form RD 3560-10* is a summary of the balances of the accounts, a listing of the liabilities, long term debts, and an indicator of the net worth of the project.

If the borrower has accurately reported actual income and expenses, specific figures on the two forms should be the same.

- Ending balances of the accounts listed on *Form RD 3560-7*, Part III should match the balances listed on *Form RD 3560-10*, lines 1-4.

- Ending cash balance on *Form RD 3560-7*, line 33 should match the balances listed on Form *RD 3560-10*, lines 1, 2, 5, and 6. These checks are a part of the analysis run in MFIS.

- Since the borrower is using the accrual method of accounting, the accrual-to-cash adjustment, *Form RD 3560-7*, line 32 must equal the difference between lines 31 and 33. This ensures *Form RD 3560-7*, lines 31 and 33 match their respective figures on *Form RD 3560-10*. The sole purpose of this adjustment is to reconcile a company's internal ledger kept on an accrual basis to the IRS forms which are required to be on a cash basis.

Borrower signatures are required on these forms. If they are submitted electronically through MINC, signed copies are not required to be submitted to the Agency.

C. Borrower Certification of Performance Standards

All financial reports must include a Borrower Certification of Performance Standards. Attachment 4-F is used by the owner to certify to these standards. The Borrower or borrower representative must sign and date this self-certification.

The Borrower must self-certify:

◊ Required accounts are properly maintained and tracked separately;

◊ Payments from operating accounts are disclosed and accurately represented;

◊ Reserve Account is current and maintained in a supervised account or have an approved Deposit Agreement executed after October 1, 2018 allowing for a non-supervised account, contributions are on schedule, the balance accounts for contributions less authorized withdrawals; and there are no encumbrances;

◊ The replacement reserve account was used for authorized purposes in accordance with 7CFR 3560.306 (g);

◊ Tenant security deposit accounts are fully funded and are maintained in separate accounts;

◊ Payment of ROI was consistent with the terms of the applicable loan agreement or loan resolution;

◊ Borrower/grantee has maintained proper insurance in accordance with the requirements of 7 CFR 3560.105;

◊ All financial records are adequate and suitable for examination.

◊ There have been no changes in project ownership other than those approved by the Agency and identified in the certification. All current owners are to be identified in the Status Report of Ownership table on Attachment 4-F. All Non-Profit Organizations certify that the board is active and maintains oversight of the property; and

◊ Real estate taxes are paid in accordance with state and/or local requirements and are current.

D. Owner's Compilation of Prescribed Forms

For-profit or limited profit borrowers that receive less than $500,000 in combined federal financial assistance, for which there are no audit requirements per other agencies or agreements, will submit an annual owner certified compilation of prescribed forms containing Form RD 3560-7 and Form 3560-10 utilizing the accrual method of accounting in accordance with Statements on Standards for Accounting and Review Services (SSARS) promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants (AICPA). Borrowers may use a CPA to complete this report of the prescribed forms. Attachment 4-K provides an example of an Independent Accountants Compilation report on RD Prescribed forms. Attachment 4-L

provides the Owner certified Prescribe forms supporting documentation schedules.

E. Financial and Compliance audit utilizing HUD Office of Inspector General's (OIG) Consolidated Audit Guide standard

For-profit or limited profit Borrowers that receive $500,000 or more in combined federal financial assistance must submit an independent auditors' report. A CPA must perform the audited financial statements.

Attachment 4-H is an example Engagement Letter which will be used by a CPA. This Engagement Letter should include the procedure, audit objectives to be performed and the fees associated with the service. There may be circumstances where the auditor may ask for information from Rural Development due to third party verification requirements. The Servicing Official shall receive a complete copy of this signed Engagement Letter prior to releasing information to the CPA. to include financial statements and notes to the financial statements, supplemental information containing Agency approved forms for project budgets and borrower balance sheets, a report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements in accordance with Generally Accepted Government Auditing Standards; a report on compliance for each major program and internal control over compliance (if applicable). Attachment 4-M provides a typical report and supporting documents.

Borrower's s will utilize HUD's Office of Inspector General's (OIG) Consolidated Audit Guide located at https://www.hud.gov/sites/documents/20004OIGH.PDF in developing the audit. The audit will not utilize HUD's Chart of Accounts, nor will the report require the CPA to review any tenant files, as this compliance test is being conducted by MFH field staff during regularly scheduled supervisory visits and annual improper payment auditing.

An audit will consist of the following items (financial statements issued in two-year comparative format, as applicable:

- Independent Auditor's Report
- Financial Statements
  - Balance Sheets
  - Statements of Operations
  - Statements of Changes in Partner's Equity (Deficit)
  - Statements of Cash Flows
- Notes to the Financial Statements

- Supplemental Information
  - Management Fee Calculation
  - Insurance Disclosure
  - Return to Owner
  - Changes in Rental Property
  - Accrual to Cash Schedule
- Multiple Family Housing Borrower Balance Sheet and supporting documentation – Form RD 3560-10
- Multiple Family Housing Project Budget and supporting documentation – *Form RD 3560-7*
- Independent Auditors Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
- Independent Auditor's Report on compliance for each major RD program and Internal control over Compliance
- Audit Findings
- Corrective Action Plan (if applicable)

F. Standards for State and local governments, Indian tribes, and Non-Profit Organizations

1. State and local governments, Indian tribes, and Non-Profit Organizations that receive less than $750,000 in combined Federal financial assistance and there are no audit requirements per other agencies or agreements will submit an annual owner certified compilation of prescribed forms containing Forms 3560-7 and 3560-10 utilizing the accrual method of accounting in accordance with Statements on Standards for Account and Review Services. A CPA may be used to complete the prescribed forms. Attachment 4-K is provided as an example.

2. State and local governments, Indian tribes, and Non-Profit Organizations that receive $750,000 or more in combined federal financial assistance must submit audits in accordance with 2 CFR 200, Part F, and the Office of Management and Budget's (OMB) Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards. Copies of the audit will be forwarded by the borrower to the Servicing Official and the appropriate Federal cognizant

agency for audit. Within USDA, the USDA, OIG fulfills "cognizant agency" for audit responsibilities, (see "cognizant agency" defined 7 CFR 3052.105).

Attachment 4-N is provided as an example of Single Audit requirements. The auditor may refer to the American Institute of Certified Public Accountants (AICPA) for additional guidance in meeting audit requirements.

Organizations subject to 2 CFR 200, Part F, must submit the single audit along with the borrower's certified performance standards (Attachment 4-F), Forms RD 3560-7, and 3560-10. Per Uniform Guidance the single audit should also be submitted using the Federal Audit Clearinghouse. The audit will not require the CPA to review tenant files, as this compliance test is being conducted by MFH field staff during regularly scheduled supervisory visits and annual improper payment auditing.

G. Other Financial Reports

- **Additional Opinions.**
  The Agency may require additional opinions of financial condition and compliance, such as audits, to ensure the security of the asset; to determine whether the project is being operated at a reasonable cost; or to detect fraud, waste, or abuse.

- **Annual Financial Statements.**
  Another regulatory agency, legal entity, and/or other business agreement may require an audit in accordance with Generally Accepted Auditing Standards or Government Auditing Standards. Any project audits independently obtained by the borrower must be submitted to the Agency.

H. Annual Financial Reporting Due Dates and Agency Review of Annual Financial Reports

1. Annual Financial Reporting Due Date

For-Profit or Limited Profit – Annual financial reports including *Form RD 3560-7* with 12 months of actual income and expenses, *Form RD 3560-10*, compilations of prescribed forms, certification of performance standards and audits, as appropriate, must be submitted to the Agency no later than 90 days following the close of the project fiscal year.

State and local Governments, Indian tribes and Non-Profit Organizations – 2 CFR §200.512 allows the audit of Not-for-profits to be submitted within the earlier of 30 days after receipt of the auditor's report, or 9 months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit.

If the annual financial reports cannot be submitted by the due date, the borrower must present a request for extension supported by evidence that delay is at the request of the auditor, and the request has a reasonable explanation of why an extension of the due date is needed. The Servicing Official may authorize up to a 30-day extension of the due date.

If an explanation is not forthcoming from the Borrower, or the explanation received is without good reason, or the Servicing Official otherwise suspects fiscal difficulty, the Servicing Official may request the borrower to submit to the Servicing Office for review, the project bank statements for the general operating, reserve, and investment accounts covering the most recent 60-day period.

If the borrower fails to submit the requested bank statements by the date stipulated by the Servicing Official, the Servicing Official will immediately refer the matter to the OIG.

The Servicing Official may authorize the initial verification of review to cover a period up to 18 months for a new project whose first operating year was less than 6 months or when an existing owner changes their fiscal year.

2. **Agency Review of Annual Financial Reports**

Loan Servicers must review financial reports within 60 days of receipt, in accordance with guidelines provided in Attachment 4-O to ensure that they meet Agency requirements. Loan Servicers will complete the checklist provided as Attachment 4-O. In particular, Loan Servicers must:

◊ Confirm that the engagement (audit report) was conducted as described in the requirements above;

◊ Confirm that the performance standards were certified as described above;

◊ Confirm that non-profit and public bodies have submitted any OMB required annual financial statements;

◊ Note any findings identified in the engagement and determine corrective actions. These would be located in the findings of the audit findings page;

◊ Utilize the MFIS analysis tool to perform the preliminary assessment of the financial statements. Refer to Attachment 4-D for the Analysis process;

◊ Confirm the information on *Forms RD 3560-7 and 3560-10,* submitted to the Agency electronically through MINC, is the same as the forms submitted with the financial reports from the auditor.

◊ If the Loan Servicer has determined that the annual financial reports are suitable, the reports may be accepted. To approve the financial reports, Loan Servicers must acknowledge acceptance (*Form RD 3560-7*). This acknowledgement may be by letter if the report was submitted electronically, or by signing and returning a copy of the form to the borrower with a letter. The Loan Servicer must also enter the final reviewed date in MFIS.

If the Loan Servicer has determined that the annual financial reports are not acceptable, a notice will be sent to the borrower explaining the issues and requesting a response within 30 days. If no response is received from this notice, servicing actions will begin using Servicing Letter #1 (HB-3, HB Letter 301(3560).

ATTACHMENT 4-A
CAPITAL EXPENDITURES

TYPICAL REPLACEMENT RESERVE ACCOUNT USE

Items traditionally contemplated as eligible for draws from the replacement reserve account include capital items such as (but not limited to):

1. Unless shown in the operating budget, replacement of range hood, refrigerators, ranges, washer, dryers and other major appliances in the dwelling units.
2. Unless shown in the operating budget, flooring and carpeting.
3. Extensive replacement of kitchen and bathroom cabinets, vanities, sinks and countertops, bathroom tubs, toilets, and doors (exterior and interior).
4. Extensive unit clean up and repairs due to tenant death, misuse of unit, damage or vermin eradication.
5. Unless shown in the operating budget, window coverings – blinds, draperies.
6. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
7. Major plumbing and sanitary system repairs
8. Permanent improvements to the housing project, such as installing an energy-conserving heat pump.
9. Overhaul of elevator systems.
10. Systematic replacement of building or unit components.
11. Major roof repairs, including major replacements of gutters, downspouts, and related eaves or soffits.
12. Repainting of the entire building exterior.
13. Extensive replacement of siding.
14. Window system replacement or extensive window screen replacement.
15. Major landscape and grounds items, such as fencing, recreation areas, property signs.
16. Major repaving/resurfacing/seal coating (sidewalks, parking lots, and driveways).
17. Extensive replacement of exterior (lawn) sprinkler systems.
18. Capital requirements identified in transition plan.
19. Automation equipment located on site.
20. Shortfalls in operating expenses beyond the control of the borrower and threatens life, safety, or the physical security of the project. Example: weather disaster.
21. Twenty-five percent of the interest earned on a reserve account during the prior year. [7 CFR 3560.306 (h)(3)].
22. Return on Investment according to 7 CFR 3560.305 (a)(2)(i) which states: “Surplus cash exists in either the general operating account as defined in 7 CFR 3560.306(d)(1) or the reserve account, if the balance is greater than the required deposits minus authorized withdrawals…”
23. Improvements to accommodate reasonable accommodation/modification requests. The replacement reserve account should not be used to pay for turnover or routine maintenance costs. Turnover and routine maintenance expenses should appear in the operating budget.

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ATTACHMENT 4-B
AMENDMENT TO LOAN AGREEMENT/RESOLUTION
RESERVE ACCOUNT REQUIREMENTS

1. **PARTIES AND TERMS DEFINED.** This amendment hereby modifies reserve account requirements contained in Form _____ dated _____ signed by _____, herein called "Borrower" with the United States of America acting through Rural Development, United States Department of Agriculture, herein called the "Government." This amendment is necessary due to increased life-cycle needs, including equipment and facility replacement costs, and is supported by a Capital Needs Assessment, dated _____.

2. **MODIFIED RESERVE ACCOUNT REQUIREMENTS.** Transfers at the rate not less than **$**_____ (monthly) shall be made to the Reserve Account beginning _____ until the amount in the Reserve Account reaches the sum of **$**_____ or according to the scheduled listed at the bottom of this form, or such higher amount later agreed to with the Government and shall be resumed at any time necessary, because of disbursements from the Reserve Account to restore it to said sum. Withdrawal and use of funds deposited to this account will be in accordance with 7 CFR part 3560. With prior consent of the Government, funds in the Reserve Account may be used by the Borrower as provided for in the original document referred to in paragraph 1.

3. All other provisions of the prior executed document referred to in paragraph 1 above shall remain in effect.

Optional Schedule (if applicable)

Monthly Transfer	Beginning Date
$_____	_____
$_____	_____
$_____	_____
$_____	_____
$_____	_____

_____ **(Borrower)**

_____ **(RD Representative)**

_____ **(Borrower)**

_____ **(Date)**

_____ **(Date)**

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ATTACHMENT 4-C
ALLOWABLE AND UNALLOWABLE PROJECT EXPENSES

There are generally accepted project expenses outlined in the MFH Regulation 7 CFR 3560.102 (management fee-related) and 3560.303 (project related) allowable expenses that should be charged to the operating account. *Text in boxed Italics* following the Regulation citation provides clarification on allowable expenses.

§3560.303 (b) Allowable and unallowable project expenses. Expenses charged to project operations, whether for management agent services or other expenses, *must be reasonable, typical, necessary and show a clear benefit to the residents of the property*. Services and expenses charged to the property must show value added and be for authorized purposes.

(1) Allowable expenses. Allowable expenses include those expenses that are directly attributable to housing project operations and are necessary to carry out successful operations.

(i) Housing project expenses must not duplicate expenses included in the management fee as defined in §3560.102(i).

- *Housing Authorities should only include cost directly associated with the operations of the MFH financed property.*

- Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This includes managers, maintenance staff, and temporary help including their:

- *On-site staff costs (including maintenance employees directly assigned) are project expenses. If staff is responsible for multiple properties, then their costs should be prorated between each property. Regional managers' costs are to be covered by the management fee.*
- *Payroll and fringe benefits expenses included in the proposed budget must agree with the number of employees, positions, salaries, fringe benefits, health plans, etc. in the management plan and the property must be able to cash flow with the included expense(s).*
- *On-Site personnel who oversee multiple properties must pro-rate the expense of benefits between properties. Wages will be charged per billing method to the property.*
- *Large increases in site payroll or site maintenance should be supported by management plan changes. RD does not have to approve a budget that includes positions that are not shown in the management plan.*
- *To be a project expense tasks must be project specific in nature.*
- *Payment of supervisory positions are paid from the management fee bundle of services and not from project operations. See §3560.102(i)(1)(i).*

(A) Gross salary;
(B) Employer FICA contribution;
(C) Federal unemployment tax;
(D) State unemployment tax;
(E) Workers compensation insurance;
(F) Health insurance premiums;

-The management plan should identify site personnel. If there is a question about health insurance coverage for site employees, Servicing Officials should review the health insurance policy for confirmation of coverage and appropriate charges to the project.
-Management's central office staff's health insurance is not a project expense.

(G) Cost of fidelity or comparable insurance;
(H) Leasing, performance incentive or annual bonuses;

-This expense is for project-specific site personnel and should be included as part of the site compensation.

(I) Direct costs of travel to off-site locations by on-site staff for property business or training; and/or

-On-site staff travel to and from the management company office to the property is an allowable expense. However, such travel should be reasonable. For example, maintenance staff should not routinely be sent out from the main office to do one thing each day when it would be more efficient to combine trips or can be completed by the on-site maintenance person.
-Other management company staff travel to and from the property is a management fee expense (see §3560.102 (i)(1)(xiii)(I))
-Purchase of "company vehicles" for such travel is not an allowable project expense.

(J) Retirement benefits.

- Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and the preparation of all legal documents.

-Property legal fees are for the borrower or the project, and not for third-parties, such as investors or syndicators.
-Fees must be paid by Borrowers from non-project funds for fines, penalties and legal fees when the borrowers are found guilty of civil rights or other violations.

- All outside account and auditing fees, if required by the Agency, directly related to the preparation of the annual audit, partnership tax returns and 401-K's, as well as other outside reports and year-end reports to the Agency, or other governmental agency.

-The account, auditing, partnership, and year end reports must be directly related to the property. It does not include individual tax filing expenses for any member of the ownership entity. Properties may have financial reporting requirements beyond that required by the Agency. If these are directly related to the property, and not the partnership or ownership, they are allowable project expenses.
-There are no regulatory caps on the audit expense, however if costs exceed the average for similar properties, confirm the audit is not of the partnership etc., which is a borrower expense.
-Utilize Agency reports to assist in the comparison process of similar properties.

(v) All repair and maintenance costs for the project including:

-Repair and maintenance expenses appear on the Form RD 3560-07 in Part II, lines 1-11. Capital expenses, which are discussed in §3560.103(c), should not appear in the operating repair and maintenance costs; capital budget expenses appear in Part V.
- Maintenance staff should not routinely be sent out from the main office to do one thing each day when it would be more efficient to combine trips or can be completed by the on-site maintenance person.
-There should be no manipulation of the budget or expenses to avoid taxes.
-The reserve account should not be used to pay for typical unit turnover or routine maintenance costs; these should appear in the operating budget. Excessive repairs due to (for example) death in the unit, drug production clean up or extreme vandalism is not typical unit turnover.
-Servicing Officials should question unusually low maintenance and repairs costs, especially in an aging property.

(A) Maintenance staffing costs and related expenses.
(B) Maintenance supplies.

Servicing Officials should carefully review this item. Small tool purchases, such as hammers, putty knives, and sprayers, which could be used repetitively, should not be repeatedly purchased by the property.

(C) Contract repairs to the projects (e.g., heating and air conditioning, painting, roofing).
Make ready expenses including painting and repairs, flooring replacement and appliance replacement as well as drapery or mini- blind replacement. (Turnover maintenance).

(D) Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.

(E) Snow removal.

(F) Elevator repairs and maintenance contracts.

(G) Section 504 and other Fair Housing compliance modifications and maintenance.

-Annual reviews updating of transition plans by management should be completed with budgets and actual financial reviews. An explanation for the lack of work and not following the transition plan schedule should be provided.
-Having an independent third party review the property every 3 years for accessibility relieves the borrower, management and Agency from making those decisions.
- Management should review the existing plan annually with a year-end update.
-A knowledgeable source or third party provider is considered one that has been recognized by a federal agency or state housing agency, National Housing organization or certification body that provides certification testing on accessibility.
-Future changes may occur to the property as a result of maintenance work, at which point, if it is not clear that the proper work is completed, a further self-evaluation and transition plan may be needed.
-If there is a change in the applicable standard or circumstances at the property the Transition plan should be updated.
-The cost of providing Limited English Proficiency (LEP) services is an allowable expense.

(I) Landscaping maintenance, replacements, and seasonal plantings.

(J) Pest control services.

-This includes the expense of bed bug control. If the property is experiencing unusual pest activity or an unusually high expense, Servicing Officials should request a breakdown of costs.

(K) Other related maintenance expenses.

-"Other maintenance expenses" is a broad category that should be carefully reviewed by Servicing Officials to ensure that charges are appropriate and reasonable. Expenses that belong in other categories should be moved by the Borrower to ensure that the Agency is collecting the correct data on specific property costs.
-If the expense appears on Part II, line 10, it must be identified.

- All operational costs related to the project including:

-"Sales tax" on management fees is not an allowable expense unless state law requires "sales tax".
-"Other Administrative" in general: Servicing Officials should closely review this line item for potential abuse. "Other Administrative" should include only directly property-related administrative costs; for example, the Section 538 Guarantee Fee is an allowable expense. A break out of the expenses should be provided with the narrative.
-Bad debts should not appear in the O & M Expense Schedule:
- On a proposed budget, bad debts will appear as a contingency item (Part I)
-On year end actuals, account for bad debt (NSF checks) would be reflected miscellaneous with a comment to explain.
-Other fees and charges should appear in the appropriate line item (i.e., bank charges, HFA compliance fees, credit checks, etc.) Such expenses must be accompanied by a narrative with detailed explanation.
-For-profit borrowers are entitled to 25 percent of the interest earnings on the Reserve account in the prior year, which should be a Reserve withdrawal request; this amount should not be taken from the operating account. See §3560.306(h)(3).

(A) The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

The cost of these items may be charged as an application fee as long as it does not exceed the actual cost of obtaining the necessary items related to the tenant selection criteria.

(B) The cost of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.

Photocopying or printing expense related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters which all directly relate to the property in question are allowable project expenses no matter what location or point of origin the work is performed. This includes outsourcing the work to a professional printer.

(C) All bank charges related to the property including purchases of supplies (e.g., checks, deposit slips, returned check fees, service fees).

Bank charges should be typical and not extraordinary; bank-charged late fees should be closely reviewed for reasonableness and not due to mismanagement. Electronic check readers and lockbox fees are an allowable project expense.

(D) Costs of site-based telephone including initial installation, basic services, directory listings, and long-distance charges.

Cell phones issued to on-site personnel for project-related work is allowable. On-site personnel who oversee multiple properties must pro-rate the expense between properties.
An allowance to a site personal for use of a personal cell phone is acceptable.

(E) All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.

This includes social media.

(F) Postage and delivery costs from the site including expenses to the Agency or other governmental agencies, tenants, verifying third parties, central management offices, etc.

Postage expenses associated with the site to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, report submittals to various regulatory authorities to the managed property are allowable project expenses no matter what location or point of origin the mail is generated.
This expense does not include normal or routine management company personnel responsibilities covered under §3560.102(i)(1)(xiii)(C).

(G) Partnership or corporate business expenses including state taxes and other mandated state or local fees as well as other relevant expenses required for operation of the property by a third- party governmental unit. Costs of continuation financing statements and site license and permit costs.

(H) Expenses related to site utilities including actual costs and surcharges as well as deposits and expense of utility bonds in lieu of bonds.

(I) Site office furniture and equipment including site-based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by the Agency).

Items must be part of a proposed approved budget to be an eligible expense. Explain in Narrative.

(J) Real estate taxes (personal tangible property and real property taxes) and expenses related to controlling or reducing taxes.

Late Fees due to mismanagement must be paid by Borrowers from non-project funds.

(K) All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.

(L) Costs of collecting rents on-site including bookkeeping supplies and recordkeeping items.

Note that these costs are for supplies such as notices;
Costs of processing transactions, maintaining books and records are covered as part of the management fee. See 3560.102(i)(1)(iii).

(M) Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies and other associated expenses.

-Office supplies, copies and other associated expenses needed to physically establish and maintain tenant files must be site-specific.

-The project management staff is responsible for the labor in preparing, reviewing, submission and maintaining tenant files and that cost is part of the salary expense to be paid by the management fee. 3560.102(i)(1)(xi).

-Costs associated with off-site tenant file storage, physical or digital, are allowable project expenses.

-Processing tenant certifications includes the transmission/submission of tenant certifications is covered by the management fee §3560.102(i)(1)(xi), is not an allowable project expense and there should not be an additional fee.

-Projects should not be double charged for "front-line fees" at a prorated rate and having personnel who are responsible for performing the same task being paid a salary is not acceptable.

(N) Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.

(O) Tax Credit Compliance Monitoring Fees imposed by HFAs.

-This expense pays the charge from the tax credit allocator.
-Reporting to general and limited partners for LIHTC, compliance purposes are included in the management fee and is not an allowable project expense; see §3560.102(i)(1)(xxvii). These fees can be paid from either management fee or return to owner.

(P) All insurance deductibles as well as adjuster expenses.

(Q) Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.)

-If costs appear unreasonable Servicing Officials should review any professional services contracts.

-The Agency has no monthly unit inspection requirement.

-Inappropriate practices are covered under §3560.102(i)(4)(viii).

-The cost of installation of project-wide cable, satellite TV, or wi-fi/Internet, is an allowable project expense, provided that each apartment unit receives a separate billing for the service, and it is not included in the rent charge or utility allowance. The property will not pay for access by each unit, including vacant units. Management could negotiate a service fee for the property and collect the monthly fee from each tenant. The budget would reflect other income source from the tenants and a cable expense in O & M. With an explanation in the narrative or comments.

(R) On-site training pre-approved by the Agency provided by outside training vendors.

-Training for on-site staff should be appropriate to managing affordable housing with subsidies from RD, HUD, or LIHTC. Suspected abuses should require documentation of the course or certifications received.
-Site training planned or completed should be explained in the narrative.
-Site staff who oversee multiple properties must pro-rate the expense between properties.

-Borrowers who attend trainings do so at their own expense and it is not an allowable project expense.
-Management company meetings to discuss management policies are a management fee expense (see §3560.102(i)(1)(xiv), (xv), (xxiv) and (xxv).
-Expenses during training should be reasonable and not involve costs for items previously identified by the OIG audit, especially gifts, bonuses (other than that identified in the management plan as part of the site manager's salary), or alcohol. Training expenses may include reasonable hotel charges, meals, and snacks; such expenses should not be excessive.

(S) Site manager salary for additional hours associated with congregate housing.

(vii) With prior Agency approval, cooperatives and Non-Profit Organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities. Such expenses may include:

(A) Errors and omissions insurance policy for the Board of Directors.
(B) Board of Directors' review and approval of proposed Agency's annual operating budgets, including proposed repair and replacement outlays and accruals.
(C) Board of Directors' review and approval of capital expenditures, financial statements, and consideration of any management comments noted.
(D) Long-term asset management reviews.

A Non-Profit Asset Management Fee may be requested by non-profits and cooperatives. Non-profit owners are entitled to up to $7,500 per project for certain organizational expenses, such as Errors and Omissions insurance and actual expenses prorated by the number of Rural Development projects.

When reviewing the justification, and the organization expenses attributed to each property, the owner should make sure that the expenses are prorated across all of the properties, and each expense is not charged in full to each property. For example if the errors and omissions insurance policy for the Board of Directors is covering all the properties and costs $3,000, the $3,000 needs to be prorated for all of their non-profit properties and non-profit properties cannot charge $3,000 per property for the insurance policy.

(2) Unallowable expenses. Housing project funds may not be used for any of the following:

(i) Equity skimming as defined in 42 U.S.C. 543 (a).
(ii) Purposes unrelated to the housing project.
(iii) Reimbursement of inaccurate or false claims.
(iv) Settlement agreements, court ordered decrees, legal fees, or other costs that result from the filing of civil rights complaints or legal action alleging the borrower, or a representative of the borrower, has committed a civil rights violation.

Borrowers must pay from non-project funds for fines, penalties and legal fees when the borrowers are found guilty of civil rights or other violations.

(vii) Fines, penalties, and legal fees where the borrower or a borrower's representative has been found guilty of violating laws, including, but not limited to, civil rights, and building codes.
(viii) Association dues to be paid by the project should be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or proration, a reasonable expense may be billed to the project.
(ix) Pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.
(x) Billing for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff.
(xi) Billing for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(c) Priorities. The priority order of planned and actual budget expenditures will be:

1. Senior position lienholder, if any;
2. Operating and maintenance expenses, including taxes and insurance;
3. Agency debt payments;
4. Reserve account requirements;
5. Other authorized expenditures; and
6. Return on owner investment.

The expense of the return on owner investment (ROI) must be included in the proposed budget in order for the Borrower to be eligible to collect the payment. §3560.305(a) includes the conditions on the return payment. §3560.305(b) discusses when an unpaid ROI may be taken:
"An earned, but unpaid ROI for the previous year only may be requested by the borrower and authorized by the Agency under the provisions of §3560.305(a)(1) provided the current year's ROI has been paid first and a rent increase is not required to generate funds to pay the unpaid ROI."

ATTACHMENT 4-D
PROPOSED BUDGET AND YEAR END ANALYSIS PROCESS
Including Return to Owner/Surplus Cash Worksheet

The summary of the budget analysis process is reviewed in the Multi-Family Integrated System (MFIS). The Agency must review this analysis for reasonableness for the budget and year end reports. If items are noted as a deficiency or concern, the Loan Servicer will determine whether the budget narrative or case file provides an adequate explanation, whether the borrower must submit a corrected budget, or if appropriate servicing actions should be considered prior to approval. The document is split into the following nine sections:

1. **Project Information**
   This area contains the Project Name, Borrower Name, State Code, Servicing Office Code, County Code, Borrower ID, Project Number, Classification, Budget Effective Date, Last Analysis Date, Project Unit counts, and Last Rent Change (year-end actual only). Vacancy data is displayed for each type of budget. Proposed budget shows the average vacancy over the last 3 years; the last 6 months; and the last month's average vacancy. Monthly, quarterly and year-end actual budgets show the vacancy covered by that period. The Loan Servicer needs to determine if the vacancy allowance is reasonable.

2. **Surplus Cash**
   This section displays the calculated amount of surplus cash per the information entered on the budget. If there is surplus cash it may need to address capital needs, make a deposit in the housing project's reserve account, reduce the debt on the borrower's loan, or reduce rents in the following year.

   The calculation used is displayed on the analysis document. (This is not displayed for Monthly/Quarterly reports)

   * **Tax & Insurance Escrow should be evaluated based on the following:**

   - **Total Annual Tax Expense / 12 months = Monthly Expense**
   - **Monthly Tax Expense x # Months remaining in fiscal year figured from last due date month = Tax Escrow Required**
   - **Insurance expense / 12 Months x # Months remaining in fiscal year figured from renewal date = Insurance Escrow Required**

   The calculation for a Proposed Budget is indicated on the following page:

RETURN TO OWNER/SURPLUS CASH WORKSHEET

CASH AVAILABLE	***EXAMPLE***
Actual Ending Cash Balance (Form RD 3560-7 Actuals Part I Line #33) (Includes Balance Sheet #1, 2, 5 & 6)	$34,000
Subtract Tax & Insurance Escrow Amount *(Escrow Analysis based on Proposed Budget)	$ 8,500
Subtract 2% Remaining Initial Operating (Balance in MFIS 2% Tracked Account)	$-0-
Subtract Accounts Payable (Balance Sheet Line #22)	$ 4,000
Cash Available	**$21,500**

CASH REQUIRED	
Proposed O & M Expense (Form RD 3560-7 Proposed Part I Line #16)	$95,000
Subtract Annual Tax & Insurance Expense (Proposed Part 2, Line 34, 37, 38 and 39)	$10,000
Subtotal	$85,000
Multiply Subtotal by 20%	20%
Cash Required	**$17,000**

SURPLUS CASH	
Cash Available	$21,500
Subtract Cash Required	$17,000
Surplus Cash	**$ 4,500**

3. **Rent Schedule Change (proposed budget only)**

This section indicates if the budget includes or does not include a rent change. If a new rent schedule is entered for the budget, the rent structure will be checked to see if the correct rents are entered dependent on the Subsidy Code of the Project and also that all revenue producing project units are covered. If these checks fail, the message "Invalid Rent Schedule Structure" will be displayed.

The amount of the rent increase will be shown as dollar value representing the average of all bedroom sizes for the project. It will be either the basic, note or HUD rent depending on the project subsidy code. Rent increases of greater than $25 will be red flagged. Increases in the other two rent types will be noted at the bottom of the section.

The Loan Servicer will review the request to determine if the proposed change is acceptable and will notify borrowers.

4. **Reserve Account Status**

This section lists information about the Reserve Account as it is within MFIS. Displayed information includes:

If a Work Out Plan is In Place, Fully Funded Amount, Annual Deposit Amount, Capital Needs Amount, Capital Needs Amount As of Date, Account Balance Amount, Account Balance Amount As of Date, Required Balance Amount, Required Balance Amount As of Date, GAP Account Amount, GAP Account Amount As of Date and Amount Behind Schedule or Amount Ahead of Schedule.

The Loan Servicer will review amounts to determine if these amounts are adequate.

5. **Reserve Account Authorizations**

The section lists the entered authorizations that still have funds available for use or were created within the last year. This will be compared to what was actually reported.

6. **Project Servicing Efforts**

The section lists all non-complete Servicing Efforts along with all completed efforts posted within the last fiscal year. A review will be made to determine if all appropriate servicing efforts are being utilized.

7. **Review Findings**

List all open non-physical findings or any created within the last fiscal year regardless of status. A review will be made to determine if these are correctly displayed and populated.

8. **Physical Findings**

This area lists all open physical findings, or any created within the last fiscal year regardless of status. A list of capital budget items with a budgeted value is also displayed to compare the project response to these findings.

9. **Budget Analysis Results**

This area contains one or more general observations or situations that raise question on the viability of the budget. Observations are just the results of a test performed that may be of importance to the servicing official. All 'Review' items must have their check box clicked to indicate they have been reviewed before the budget is considered analyzed and therefore can be approved.

If the item is corrected it will not be displayed the next time the analysis is executed. If the item is reviewed, a comment must be entered as to why the situation is OK. The budget may not be approved if any review item remains present and not marked as reviewed in this section. Once an item is marked as reviewed (or comment entered), it will maintain those changes in future analysis runs.

A detailed list of the tests that are executed on the indicated lines of the budgets is available in the MFIS Message Board under Frequently Asked Questions. The results of the tests will display in the analysis report.

The following tests are common across multiple line items:

1. **TYPO CHECK** – all input values of Proposed, Monthly/Quarterly or Year-End Actual budget line items – system will flag if:

- If the input value is equal or greater than 100 times the last year's value (if last year's value is not zero).
- If the input value is equal or greater than $1,000,000.

2. **MONTHLY/QUARTERLY CHECK** – some Monthly/Quarterly budget line items

- All Part I input lines period and YTD are compared to the associated proposed for expected period value
- All Part II subtotals period and YTD are compared to the associated proposed for expected period value

3. **GENERAL RULE** – for some Year-End Actual line items

- If the proposed budget had a non-zero value, the actual should have a non-zero value.

4. **10 PERCENT RULE** – for some Proposed and Year-End Actual line items
Proposed items - if proposed budget value differs from last year's value by more than 10 percent (even if last year's value was zero) MFIS will comment about a narrative explanation

- Actual items - if actual budget differs from proposed by 10 percent or more it is flagged for review.
- The system checks operating expenses and income sources to see if subtotals are more than 10 percent different from last years. If this is the case, determine if the budget narrative provides an adequate explanation for the unusual item.

5. **$12 RULE** – for direct comparison of numbers on some Proposed and Year-End Actual line items such as correct debt payment, correct reserve payment, owner's return on investment:

- If values differ by more than +- $12.00 then flag as a REVIEW item
- If values differ by less or equal to +- $12.00 then flag as an OBSERVATION item
- If any of these are unacceptable, the borrower will need to submit a new budget.

6. **COMMENT RULE** – for some Proposed and Year-End Actual line items

- OTHER type line items with a value require a comment
- LIST type line item with a value require a comment

7. **INHERITANCE RULE** – for some Proposed line items

- If last year's actual had a value and this years proposed does not have a value

8. **RATIO ANALYSIS** - are reflected in the Budget Analysis. Ratios are an effective tool for financial analysis. They prescribe various measures of actual operating performance. The ratios should be reviewed for a comparative analysis. The Loan Servicer should become familiar with these percentages as a comparative analysis and should consider utilizing the Hyperion MFH Budget Line Item Comparative Cost data report for their Region in their analysis. The ratios run in the MFIS Analysis Review are as follows:

- Maintenance and Operating Expense / Total Operating & Maintenance
- Utilities/Total Operating & Maintenance
- Administrative/Rental Income
- Total Operating & Maintenance/Rental Income
- Per Unit Per Month Operating & Maintenance Expense
- 3-year Resident Turnover Rate

9. **NORMS** - are also reviewed on the Budget Analysis. The Norms are based on Regional Groupings of "like" properties. This gives the Servicer an analysis of how the property is comparing to other "like" properties. The norm definitions are as follows:

- Utility Allowance: If Rent schedule has one yes, else no.
- Profit type: Code = 1 or 2 yes, else no
- Tax Status: Line 34 > 0 yes, else no
- Interest Credit: Plan code = 07, 08, 21, 24 yes, else no
- Age (years): <6, <11, <20, <30, all others
- Size (units): <5, <12, <24, <40, <80, all others
- Elderly: Rental code = EL, CG yes, else no

The States are grouped into regions as follows:

1. CT, MA, ME, NH, RI, VT
2. NJ, NY
3. DE, MD, PA, VA, WV
4. AL, FL, GA, KY, MS, NC, SC, TN
5. IL, IN, MI MN, OH, WI
6. AR, LA, NM, OK, TX
7. IA, KS, MO, NE
8. CO, MT, ND, SD, UT, WY
9. AZ, CA, HI, NV
10. AK, ID, OR, WA
11. PR, VI, WP, GUAM

10. Look at the cash flow and ending cash balance.
    a. Cash flow: Is the cash flow positive? A negative cash flow is permissible as long as it does not appear to represent a trend that cannot be corrected.
    b. Cash balance:
        i. If cash flow is negative, what is the ending cash? Does it cover the negative cash flow?
        ii. Does the ending cash balance exceed the permissible limit? If so, the surplus must address capital needs, be deposited in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year.
        iii. Using the accrual method of accounting, the accrual to cash adjustment must equal the difference of Beginning Cash Balance and Ending Cash Balance to insure these balances match their respective Balance Sheet figures. The sole purpose of this adjustment is to reconcile a company's internal ledger kept on an accrual basis to the IRS forms which are required to be on a cash basis.

If the analysis of cash flow and cash balance reveals a problem, appropriate servicing actions should be considered prior to budget approval.

Attachment 4-E
AUDIT PROGRAM

USED TO REPORT CONSTRUCTION COST ENGAGEMENTS.
(For additional guidance refer to HB-1-3560 Loan Origination Handbook.)

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington D.C. 20250

AUDIT PROGRAM	Rural Development Rural Housing Service Multi-Family Housing Division Rural Rental Housing Program

This audit program provides instruction and guidance for independent public accountants in conducting agreed-upon procedures engagements of recipients of Rural Development loans, except for those audits required to be performed in accordance with Office of Management and Budget Circular A-133. The audit program is effective for the period ending December 31, 2005, and thereafter.

This audit program may not be changed, altered, revised, or modified without the concurrence of the Office of Inspector General.

APPROVED BY: Robert W. Young
ROBERT W. YOUNG
Assistant Inspector General
for Audit

9/29/04
Date

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EXHIBIT A – ILLUSTRATIVE AUDITOR'S AGREED-UPON PROCEDURES REPORT (FORM RD 1924-13)

I. GENERAL

A. PURPOSE

This guide is designed to assist independent public accountants (practitioners) in conducting agreed-upon procedures engagements of Rural Rental Housing (RRH) properties financed by Rural Development. The RRH Program has a history of abuse involving the construction and ongoing operation of properties. This guide includes procedures to assist the practitioner in determining borrower and management company compliance with certain statutory, regulatory, and contractual requirements of the RRH Program. Thus, practitioners need to be familiar with laws, regulations, and procedures related to the RRH Program.

B. BACKGROUND

Rural Development uses cost certifications to verify that borrowers spent loan funds for eligible and actual costs when constructing apartment complexes as part of the RRH Program.

RRH borrowers typically use identity-of-interest companies in both the construction of apartment complexes and in managing the day-to-day operations of RRH properties. RRH borrowers that have an identity-of-interest with the borrower (general contractor) are required by Rural Development to report the actual costs of construction on *Form RD 1924-13, Estimate and Certificate of Actual Cost.* In addition, *Form RD 1924-13* must be submitted whenever there is an identity-of-interest relationship between a borrower and a subcontractor, material supplier, or equipment lessor.

The USDA Office of Inspector General has performed audits and investigations that identified significant fraud and abuse in the RRH Program. Some of the fraud and abuse related to construction includes: Ineligible, unsupported, and duplicate costs; misrepresentation by borrowers of their roles as general contractors; shifting costs (e.g., overhead expenses) that exceeded budgeted amounts to different cost categories on *Form RD 1924-13*; and using identity-of-interest companies which are merely "shell" companies to either inflate legitimate charges or bill properties for costs that were never incurred.

Similar abuse using identity-of-interest companies has been identified in the ongoing management of RRH properties. Borrowers and management companies also charge ineligible, unsupported, and duplicate expenses (generally for management related costs) to properties. Also, management companies frequently do not maintain suitable records when of properties, and overcharge for these services. Rural Development regulations refer to any scheme that improperly withdraws funds from RRH project accounts as "equity skimming."

USDA Office of Inspector General audits have also identified instances of conflicts of interest and a lack of independence on the part of certified and licensed public accountants when performing audits of RRH properties. Thus, practitioners should strictly adhere to the standards and principles of the American Institute of Certified Public Accountants' Code of Conduct and Bylaws and applicable State Boards of Accountancy.

C. PERTINENT REGULATIONS AND INSTRUCTIONS

Construction Cost:

The instructions for *Form RD 1924-13* provide guidance on eligible construction costs, as well as the required format for the presentation of costs. Rural Development has also established regulations that restrict the amount of builder's profit for each project, the use of identity-of-interest companies, and the business relationships of practitioners performing engagements of RRH construction costs. The following regulations and Rural Development instructions should be used as guidance:

- Rural Development Instruction 1924-A, and
- Rural Development 7 CFR 3560.

Management of Ongoing Operations:

Rural Development regulation 7 CFR 3560 provides details on allowable and unallowable operating costs, and places restrictions on the use of identity-of-interest companies and other activities related to managing RRH properties.

D. STANDARDS FOR CONDUCTING THE AGREED-UPON PROCEDURES ENGAGEMENTS

Practitioners are to perform attestation engagements using agreed-upon procedures of construction costs and ongoing operations in accordance with attestation standards established by the American Institute of Certified Public Accountant's (AICPA) and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States." The practitioner's report on agreed-upon procedures should be in the form of procedures and findings. (See exhibit A for an illustrative example.)

If practitioners become suspicious of fraud or illegal acts during the course of performing the agreed-upon procedures engagement, they are to promptly report these matters (regardless of materiality) to:

U.S. Department of Agriculture
Rural Development - Rural Housing Service
Director, Multi-Family Housing Processing
Division 1400 Independence Avenue, SW
Washington, D.C. 20250
Telephone: (202) 720-3773

The report and workpapers prepared in the course of these engagements are subject to a quality control review by the USDA Office of Inspector General.

E. OBJECTIVES

The objective of the construction cost engagement is to verify the propriety of costs reported on *Form RD 1924-13*. The practitioner should be alert for kickbacks on the purchase of services and materials, billings in excess of agreed-upon prices, billings for non-existent materials or services, "sweetheart contracts," and the diversion of materials to other construction sites.

Of primary concern is compliance with general contractor and management company requirements and the role of identity-of-interest companies in the construction and management of RRH properties.

II. CONSTRUCTION COST ENGAGEMENTS

A. AGREED-UPON PROCEDURES FOR THE CONSTRUCTION COST ATTESTATION ENGAGEMENT

The procedures in this section are designed to identify ineligible expenses and fictitious charges to Form RD 1924-13. Per 7 CFR 1924 subpart A and the instructions for preparing *Form RD 1924-13* provide guidance on eligible construction costs.

Borrowers and contractors involved in the construction of Rural Development financed RRH properties are required to maintain recordkeeping systems which establish accounts that categorize costs in conformity with sections 1924.13 (e) (1) (v) (A) and 1924.13 (e) (2) (i) (H) of RD Instruction 1924-A. *Form RD 1924-13* includes a certification that the cost of labor, materials, and other necessary services incurred during construction are accurate and fairly presented.

Borrowers are required to comply with laws, regulations, and Rural Development procedures related to the construction of RRH properties. USDA Office of Inspector General audits have identified borrowers that received builder's profit for being the general contractor when, in fact, general contractor responsibilities were being performed by other contractors. The audits also disclosed that some identity-of-interest companies were merely "shell" companies with no employees, inventory, or other business activities. Other identity-of-interest companies have charged rental fees for equipment use for the entire construction period when the equipment was actually used for short or intermittent periods during construction.

These actions have resulted in significant amounts of overcharges to RRH properties. Sections 1924.13 (e) (1) (v) (H) and 1924.13 (e) (2) (viii) of RD Instruction 1924-A prohibit borrowers from receiving builder's profit for

acting as the general contractor if more than 50 percent of the property is subcontracted to one subcontractor or 75 percent to three or fewer subcontractors. Sections 1924.13 (e)(1)(v) (I) and 1924.13 (e)(2)(viii) (D) of RD Instruction 1924-A Contractors, subcontractors, material suppliers, and any other individual or organization sharing an identity of interest and providing materials or services for the project must certify that it is a viable, ongoing trade or business qualified and properly licensed to undertake the work for which it intends to contract.

Agreed-Upon Procedures

1. Compare the total amount paid through the construction checking account (by adding the total amount from monthly statements) to the total amount of costs reported on *Form RD 1924-13*. Report any differences.
2. Examine selected checks, invoices, job cost ledgers, receiving documentation, etc., that support costs presented on *Form RD 1924-13* to ensure they were actually incurred to construct the project. (Note: Verify that checks have been cancelled and ensure that indirect costs are not included with the cost of labor and materials on *Form RD 1924-13*.)
3. Inspect selected checks held as retainage from subcontractors for evidence that they were actually paid by the bank. Confirmation with subcontractors may be necessary if cancelled checks are not available or not cancelled by the bank. (Note: Office of Inspector General audits have disclosed instances where checks were made to subcontractors, but never cashed.)
4. Compare the address on selected delivery documents and invoices (using the sample from audit step II.A.2.) to the project's address to ascertain whether materials and services were provided to the project under review. (Note: Office of Inspector General audits have disclosed instances where delivery was not made to the RRH project site.)
5. Examine selected cancelled checks related to accounts included in the "to be paid" column of *Form RD 1924-13* to determine the propriety of the costs reported. (Note: Office of Inspector General audits have disclosed instances where these costs were invoiced by identity-of-interest companies but were never actually paid by the borrower.)
6. Confirm payments with selected subcontractors and material suppliers and investigate any discrepancies. (Note: be alert for any discounts, rebates, or refunds that were provided to the contractor but not included on *Form RD 1924-13*.)
7. Inspect selected bid documentation to verify that the lowest bid submitted was accepted. If the lowest bid was not accepted, evaluate the justification for the higher bid. If documentation does not exist, report this and the reason why as a finding. (Note: be alert for "sweetheart contracts" and contracts to disclosed or undisclosed identity-of-interest companies.)
8. Compare selected subcontractor billings (invoices) to contract amounts. If billings were in excess of contractual terms, ascertain the reason for the higher expenses.

9. Obtain the number of subcontractors used during construction and calculate the percentages of subcontractors to ensure compliance with Rural Development requirements.[1]
10. Examine selected accounting records for undisclosed identity-of-interest companies. The practitioner should focus on transactions involving the use of one or two contractors/subcontractors, or if one contractor/subcontractor provided a significant percentage of materials or services.
11. Determine if identity-of-interest companies meet Rural Development requirements[2] of providing services to the general public.

    a. Question the general contractor/borrower about the business activities of any identity-of-interest company used and request evidence that the company provides services or materials to the general public.
    b. Review identity-of-interest records (e.g., sales records, invoices, receiving documents, etc.).
    c. Confirm by independent verification that identity-of-interest companies exist and provide services to the general public. (Note: This evidence could include listings in a telephone directory, advertisement to the public, etc. Also, be alert for "shell" companies that exist solely for processing invoices and adding markups to the original supplier's invoices. Markups made by identity-of- interest companies that do not provide services/supplies to entities other than the RRH property are not allowable.)
12. Compare equipment rental and supervision charges by identity-of-interest companies to independent rental companies to determine reasonableness[3] of charges. Report any significant variances.

    a. Question the borrower about the use of equipment during construction and how rental rates were established and time of use determined.
    b. Contact an independent rental company to determine commercial rental rates and compare them to the identity-of-interest charges.
    c. Examine borrower documentation (e.g., commercial rate lists, time sheets, construction schedules, etc.) to support the rates that were used and time that was charged for equipment rental fees. (Note: Office of Inspector General audits have disclosed that borrowers are charging rental fees when equipment is not in use.)
    d. Question the borrower about supervision charges.
    e. Verify that the borrower has documentation (e.g., timesheets or timecards, travel reports, payroll records, etc.) to support supervision charges.

[1] Sections 1924.13 (e) (1) (v) (h) and 1924.13 (2) (2) (viii).
[2] Sections 1924.13 (e) (1) (I) and 1924.13 (2) (viii).
[3] A charge would be considered reasonable if it is approximately the same amount of cost that a non-identity-of-interest company would charge.

Illustrative Auditor's Agreed-Upon Procedures Report

(Form RD 1924-13)

To the Owners and Management Company of *(name of RRH project, city and State)* and the project's financial accounts:

We have performed the procedures enumerated below, which were agreed to by Rural Development and the owner of *(name of RRH project, city and State)* and the project's financial accounts, solely to assist those parties in evaluating the accompanying (*Form RD 1924-13, Estimate and Certificate of Actual Cost*) prepared in accordance with the criteria specified in Rural Development Regulations 1924 for the year ended December 31, *(applicable year)*. The owner is responsible for *(name of the RRH project)* financial accounts. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of Rural Development. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The agreed-upon procedures performed during this engagement were included in the audit program designed for the Rural Rental Housing Program dated September 29, 2004. The findings for each of the agreed-upon procedures are as follows.

(Agreed –Upon Procedure No.) (Finding) (Agreed –Upon Procedure No.) (Finding) (Agreed –Upon Procedure No.) (Finding) (etc)

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the financial statements of *(name of RRH project, city and State)*. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the owner and management company of *(name of RRH project, city and State)*, and Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

(Signature)

(DATE)

ATTACHMENT 4-F

Performance Standards
Borrower Self-Certification Letter

Date

USDA Rural Development Office
Address
Address

In accordance with the criteria specified in Section 5; Paragraph 4.16 C. of the USDA Rural Development Handbook (HB-2-3560) for the year ended ***DATE, YEAR***, the borrower must self-certify that ***PROJECT NAME*** is in compliance with the nine performance standards. The following is a summary of our compliance with the performance standards.

1. The required accounts are *(are not)* properly maintained and tracked separately. The accounts we maintain are marked below:

   __ Operating Account(s) __ Security Deposit Account
   __ Tax & Insurance Account __ Reserve Account
   __ Other Accounts: _____

2. The payments from operating account(s) are *(are not)* disclosed and accurately represented.

3. The reserve account(s):
   a. is on *(not on)* schedule with the Agency required minimum funding requirements;
   b. is *(is not)* maintained in a supervised bank account that requires the Agency's countersignature on all withdrawals;
   c. is *(is not)* maintained in a bank account that has a fully executed Depository Agreement dated after October 1, 2018 and has received Agency approval prior to withdrawals;
   d. is on *(not on)* schedule with contributions to the reserve account for the current year with the Agency required minimum funding;
   e. has no *(has)* encumbrances on the reserve funds; and
   f. replacement reserve accounts were *(were not)* used only for authorized purposes in accordance with 7 CFR 3560.306(g).

4. The tenant security deposits accounts are *(are not)* fully funded and are (*are not)* maintained in separate accounts.

5. The payment of owner return was:

   __ paid in the amount of $_____ for 20XX fiscal year and was *(was not)* in accordance with the Agency's requirements; OR
   __ not paid during the reporting year; OR
   __ not allowable due to our non-profit status; OR
   __ not allowable due to our non-profit status. However, an asset management fee in the amount of $_____ was paid for 20XX fiscal year.

6. The borrower has *(has not)* maintained proper insurance in accordance with the requirements in 7 CFR 3560.105. Coverage maintained for ***PROJECT NAME*** is as follows:

   __ Liability Insurance __ Flood Insurance
   __ Property Insurance __ Earthquake Insurance
   __ Fidelity Bond __ Other: _____

7. All financial records are *(are not)* adequate and suitable for examination.

8. There have been no changes in the ownership of ***PROJECT NAME***, other than those approved by the Agency and identified in the certification. All current owners are identified in the Status of Ownership table in this Certification. This includes all General Partners, Limited Partners, President, Vice President, Secretary, Treasurer, Member and other Partners as applicable.

   For non-profit borrowers: The Board of Directors is *(is not)* active and maintains oversight responsibilities for the project.

9. The real estate taxes (property taxes) are paid in accordance with state and/or local requirements. As of ***YEAR-END DATE,*** there are no delinquent real estate taxes (property taxes).

I certify that the above is true, accurate and is properly supported by documentation kept in our files.

[Signature of Borrower] _____

PRINTED SIGNATURE _____

DATE _____

BORROWER ENTITY NAME _____

NOTE TO BORROWER: *If the project is not in compliance with any of the above Performance Standards, you must state that you are not in compliance with the standard and provide the Agency with a statement about the non-compliance and the methods taken to correct the non-compliance.*

STATUS REPORT OF OWNERSHIP

FISCAL YEAR _____

_____

BORROWER NAME

TITLE	NAME	ADDRESS PHONE NUMBER	TAXPAYER ID NUMBER

_____The above information is current and there have been no changes in the ownership since the inception of the loan agreement/resolution(s), except as approved by the Agency. *(7 CFR 3560.405 (c) (2))*

_____There has been/will be a change in the ownership as reflected above. For any change in the ownership, information is attached as required by *7 CFR 3560.405 (c) (3)* and *HB-3-3560, Chapter 5 or 7* as applicable.

_____ _____
Date Owner

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ATTACHMENT 4-G

RD MFH PROGRAM AUDIT DETERMINATION WORKSHEET

Step 1: Gather all the information below to determine whether a Financial and Compliance audit is required by Rural Development.

RD Borrower Name: _____ **Borrower ID:**_____

RD projects associated with ID _____ _____
(List all – may need additional pages)

Federal Financial Assistance Received Current Year (See Section 4.16)

RD 515 Loan balances at beginning of FY	_____	_____
Interest Subsidy	_____	_____
RD Rental Assistance	_____	_____
HUD Section 8 Assistance	_____	_____
RD GRRH 538 Loan balance	_____	_____
Other: _____	_____	_____

Total Federal Financial Assistance received from the borrower: $_____

Step 2: Is the RD project owned by a State, Local Government, Indian tribe or not-for-profit entity?

No, go to step 3

Yes- Was $750,000 or greater, in the aggregate, in Federal Financial Assistance received?

Yes -follow the rules under Exhibit 4-7 of this HB 2 3560 Ch 4 and the single audit requirements under 2 CFR part 200.

No, go to Step 5.

Step 3: Did the borrower receive $500,000 or greater, in the aggregate, in Federal Financial Assistance?

Yes, an RD Financial and Compliance Audit is necessary. Go to Step 4.

No, go to Step 5.

Step 4: Are any of the individual programs identified in Step 1 equal to or greater than $500,000?

Yes, these program(s) are the property's major program(s). A major program report is required. Refer to Attachment 4-I.

No, there are no major programs. A major program report is not required in the audited financial statements.

Step 5: Does another regulatory agency, legal entity, and/or other business agreement require an audit in accordance with Generally Accepted Auditing Standards or Government Auditing Standards?

Yes, submit a copy of that audit to RD. This audit must contain the required reporting information illustrated in this Chapter.

No, Go to Step 6.

Step 6: Submit a compilation of prescribed forms as outlined in Chapter 4.16.

ATTACHMENT 4-H
Example Engagement Letter —For-profit Entity $500,000 or greater in Federal Financial Assistance

[CPA Firm's Letterhead]

Date, Year

Name
Company Name
Address
City, State Zip

We are pleased to confirm our understanding of the nature and limitations of the services our firm will provide for each of the Entities detailed in Exhibit A.

We will perform an audit of the balance sheet as of ***DATE, YEAR***, and the related statements of operations, changes in partners' equity and cash flows for the year then ended. Also, the supplementary financial information required by the *United States Department of Agriculture RD Handbook HB-2-3560* listed below will be subjected to the auditing procedures applied in our audit of the financial statements:

- Calculation of Management Fee
- Return to Owner
- Insurance Detail
- Changes in Rental Property Ownership
- Accrual to cash schedule

AUDIT OBJECTIVES

The objective of our audit is the expression of an opinion about whether the financial statements are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements taken as a whole. The objective also includes reporting on each Entity's Internal controls and its compliance with certain provisions of laws, regulations, contracts, and grant agreements in conformity with auditing standards generally accepted in the United States of America and as required by *Government Auditing Standards* and the *United States Department of Agriculture RD Handbook HB-2-3560*. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America, the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the *United States Department of Agriculture RD Handbook HB-2-3560.*

AUDIT PROCEDURES - General

Our audit will include tests of the accounting records of each Entity and other procedures we consider necessary to enable us to express such an opinion and render the required reports. If our opinion is other than unqualified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or to issue a report as a result of this engagement.

The report on internal control and compliance will include a statement that the report is intended for the information and use of the partner, management, others within the organization and the United States Department of Agriculture Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

The management of each Entity is responsible for establishing and maintaining effective internal control and for compliance with the provisions of applicable laws, regulations, contracts, and grant agreements. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of the controls. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that Rural Development programs are managed in compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

In planning and performing our audits, we will consider the internal control sufficient to plan each audit in order to determine the nature, timing, and extent of our auditing procedures for the purpose of expressing our opinions on the Entity's financial statements and on its compliance with specific requirements applicable to its Rural Development programs and to report on the internal control in accordance with the provisions of *Government Auditing Standards* and not to provide any assurance on the internal control.

We will obtain an understanding of the design of relevant controls and whether they have been placed in operation, and we will assess control risk. Tests of controls may be performed to test the effectiveness of certain controls we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other non-compliance matters that have a direct and material effect on the financial statements. (Tests of controls are required only if control risk is assessed below the maximum level.) Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

We will perform tests of controls over compliance, as required by *Government Auditing Standards* and the *United States Department of Agriculture RD Handbook HB-2-3560*, to evaluate the effectiveness of the design and operation of controls that we consider relevant to

preventing or detecting material non-compliance with specific requirements applicable to each Entity's Rural Development programs. Our tests will be less in scope than would be necessary to render an opinion on these controls and accordingly, no opinion will be expressed.

AUDIT PROCEDURES – Internal Control
Our audit will include obtaining an understanding of internal control sufficient to plan each audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. However, during the audit, we will communicate to you, internal control related matters that are required to be communicated under professional standards.

Identifying and ensuring that each Entity complies with laws, regulations, contracts, and grant agreements is the responsibility of management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of each Entity's compliance with applicable laws and regulations, and the provisions of contracts and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and we will not express such an opinion.

Our audits will be conducted in accordance with the standards referred to in the third paragraph. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether material non-compliance with the requirements described in the *United States Department of Agriculture RD Handbook HB-2-3560* that are applicable to its Rural Development programs occurred. The purpose of each audit will be to express an opinion on each Entity's compliance with specific requirements applicable to major programs listed in the previous sentence.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the account, and may include direct confirmation of cash, investments, loan balances, and certain other assets and liabilities by correspondence with certain individuals, creditors and financial institutions. We may also request written representations from your attorneys as part of each engagement, and they may bill you for responding to that inquiry. At the conclusion of each engagement, we will require a written representation letter from the owner and or management of each specific Entity that, among other things, will confirm management's responsibility for the presentation of the financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audits will involve judgment about the number of transactions to be examined and the areas to be tested. Also, we will plan and perform the audits to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations that are attributable to each Entity or to acts by management or employees on behalf of each Entity. Because the

determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse. As required by *Government Auditing Standards*, our audits will include tests of transactions related to federal awards programs for compliance with applicable laws and regulations and the provisions of contracts and agreements.

Because an audit is designed to provide reasonable, but not absolute, assurance and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or non-compliance may exist and not be detected by us. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or on major programs. However, we will inform you, of any material errors and any fraudulent financial reporting or misappropriation of assets that comes to our attention. We will also inform you of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential. We will include such matters in the reports required for Rural Development audits. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

You are responsible for establishing and maintaining internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; and for the fair presentation in the financial statements of financial position, changes in partners' capital, and cash flows in conformity with accounting principles generally accepted in the United States of America. You are also responsible for management decisions and functions; for designating a management-level individual with suitable skill, knowledge, or experience to oversee the tax services and any other non-attest services we provide; and for evaluating the adequacy and results of those services and accepting responsibility for them.

OTHER SERVICES

As part of our engagements:

We will not perform any management functions or make management decisions.

We will assist you and/or management in the calculation of depreciation expense and maintenance of fixed asset and depreciation records, however, you and/or management shall be responsible for determining the depreciation method, rate and life of each class of assets and determining salvage value, if any. You and/or management shall be solely responsible for the completeness and accuracy of the related fixed asset and depreciation schedules.

We will prepare a general ledger trial balance for use during each engagement. Our preparation of the trial balance will be limited to formatting information in the respective Entity's general ledger into a working trial balance.

We will also prepare federal, state and local income tax returns for the Entities listed in the attached Exhibit A for the year ended **DATE, YEAR**. You are responsible for the decisions and functions of your property, and for designating a competent employee to oversee these services.

You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for the results. You are also responsible for establishing and maintaining internal controls, including monitoring ongoing activities. You should be aware that, under the Internal Revenue Service Restructuring and Reform Act of 1998, certain information discussed by you with members of our firm who are authorized tax practitioners or their agents for the purpose of obtaining our firm's advice on tax matters is privileged from disclosure in any non-criminal tax matters before the IRS. Information compiled for the purpose of preparing a tax return is not privileged under common law because it is intended for disclosure to the IRS or others. The privilege will be waived if the communication is voluntarily disclosed to a third party. Professional standards require us to discuss matters that may affect the engagement with our firm personnel responsible for non-attest services, which includes tax services. The IRS might not take the position that such communication results in a waiver of privilege.

MANAGEMENT RESPONSIBILITIES

Management is responsible for making all financial records and related information available to us, including any significant vendor relationships in which the vendor has the responsibility for program compliance. We understand that you will provide us with such information required for each audit and that you are responsible for the accuracy and completeness of that information. Management's responsibilities include adjusting the financial statements to correct material misstatements and for confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud or illegal acts or illegal acts affecting each Entity involving management, employees who have significant roles in internal control, and others where the fraud or illegal acts could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud or illegal acts affecting each Entity received in communications from employees, former employees, regulators, or others. In addition, management is responsible for identifying and ensuring that each Entity complies with applicable laws and regulations and for taking timely and appropriate steps to remedy any fraud, illegal acts, violations of contracts or grant agreements, or abuse that we may report.

As part of each audit, we will prepare a draft of your financial statements, supplementary financial information, and related notes. In accordance with *Government Auditing Standards*, you will be required to review and approve those financial statements prior to their issuance and have a responsibility to be in a position in fact and appearance to make an informed judgment on those financial statements. Further, you are required to designate a qualified management-level individual to be responsible and accountable for overseeing our services.

We will submit our report for each of the Entities in Exhibit A listing the procedures performed and our findings. Each report is intended solely for the use of the project's owners, the management agent and Rural Development, and should not be used by anyone other than these

specified parties, and take responsibility for the sufficiency of the procedures for their purposes. Our reports will contain a paragraph indicating that had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

At the conclusion of each engagement, we will require a representation letter from the owner and or management of each specific Entity that, among other things, will confirm management's responsibility for the presentation of Forms RD 3560-7 and 3560-10 in accordance with the criteria specified in 7 CFR part 3560 Section 303(b) and 7 CFR part 3560 Section 306, for the year ending DATE, YEAR and management's responsibility for compliance with the requirements of 7 CFR part 3560 Sections 308(a), 308(b) and 308(c).

During the course of each engagement, we shall request information and explanations from the owner and/or management regarding the respective Entity's operations, internal controls, compliance matters, future plans, specific transactions, and accounting system and procedures. We understand that your employees will prepare all cash, vendor, accounts payable and other confirmations we request and will work with our staff to locate any documents selected by us for testing. We will request written confirmation from financial institutions as part of each engagement, and they may bill you for responding to that inquiry.

At the conclusion of each engagement, we will require, as a precondition to the issuance of our report, that management reconfirm this information in a written representation letter. The procedures which we will perform in each engagement will be heavily influenced by the representations that we receive from you and/or management. Accordingly, false representations could cause us to expend unnecessary efforts or could cause a material error or a fraud to go undetected by our procedures. You acknowledge that as a condition of our agreement to perform each engagement, you and all members of your management, agree to the best of your knowledge and belief to be truthful, accurate, and complete in the representations you make to us during the course of each engagement and in the written representations provided to us at the completion of each engagement. In view of the foregoing, you agree that we shall not be responsible for any misstatements in the financial and compliance reports as a result of false or misleading representations that are made to us by you or your management. In addition, because our failure to detect material misstatements could cause others relying upon our report to incur damages, you and management further agree to indemnify and hold us harmless for any liability and all reasonable costs (including legal fees) that we may incur in connection with claims based upon our failure to detect material misstatements in the respective Entity's financial and compliance reports resulting from false or misleading representations made to us by you or any member of your management.

Management is also responsible to notify us in advance of your intent to print our reports in whole or in part, and to give us the opportunity to review any printed material containing our reports before its issuance.

The documentation for these engagements is the property of **CPA FIRM NAME** and constitutes confidential information. However, we may be requested to make certain documentation available

to the United States Department of Agriculture acting through Rural Development, the Office of Inspector General (OIG) and the Government Accountability Office (GAO) or their representatives, pursuant to authority given to them by law or regulation. We will notify you of any such request. If requested, access to such documentation will be provided under the supervision of **CPA FIRM NAME** personnel. Furthermore, upon request, we may provide copies of selected documentation to Rural Development, OIG or GAO representatives. Rural Development, OIG and GAO may intend, or decide to distribute the copies or information contained therein to others, including other governmental agencies. We may also be requested to make certain documentation available to the investment partner(s)/member(s) or their representatives pursuant to authority given to them by the Partnership/Operating Agreement. Access to such documentation will be provided under the supervision of **CPA FIRM NAME**. Furthermore, upon request, we may provide photocopies of selected documentation to the investment partner(s)/member(s) or their representatives and they may intend or decide to distribute the photocopies or information contained therein to others, including governmental agencies.

Each engagement ends on delivery of our financial and compliance reports. Any follow-up services that might be required will be a separate, new engagement. The terms and conditions of that new engagement will be governed by a new, specific engagement letter for that service.

ENGAGEMENT ADMINISTRATION, FEES, AN OTHER

Our fees for these services are based upon the actual time spent at our standard hourly rates, travel, and other out-of-pocket costs such as report production, word processing, postage, etc. Our standard hourly rates vary according to the degree of responsibility involved and the experience level of the personnel assigned to each engagement. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. In accordance with our firm policies, work may be suspended if your account becomes XX days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for non-payment, each engagement will be deemed to have been completed even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination. The suspension or termination of our work may result in adverse consequences to you including your failure to meet deadlines imposed by governments, lenders, or other third parties. You agree that we will not be responsible for your failure to meet such deadlines, or for penalties or interest that may be assessed against you resulting from such failure. Based on our preliminary estimate, the audit and tax procedure fees will be as detailed in Exhibit A. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the engagements. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.

Government Auditing Standards require that we provide you with a copy of our most recent external peer review report and letter of comments, and any subsequent peer review reports and letters of comment received during the period of the contract. Our peer review report and letter of comments accompanies this letter.

We appreciate the privilege and opportunity to work with you and your staff during the completion of these important engagements. If the engagement letter terms are acceptable and in accordance with your understanding of each engagement, please sign the attached agreement and return the signed agreement page. Please retain the original letter and the client copy of the agreement page for your files. If you have any questions or comments regarding the terms of this engagement letter, please do not hesitate to contact us.

Very truly yours,

CPA FIRM NAME
Certified Public Accountants

EXHIBIT A

Entity and Fee Schedule
Year End DATE, YEAR

ENTITY NAME	FEE AMOUNT

Exhibit B

[CPA FIRM NAME] SERVICE AGREEMENT

Agreement to report on Rural Development Financial and Compliance Reports and prepare Federal, State & Local tax reporting forms for the Entities listed in the Exhibit A managed by Company Name as outlined in the CPA FIRM NAME engagement letter dated Date, Year.

To accept the schedule of fees in Exhibit A and the terms as stated in the attached engagement letter:

- Sign below,
- Return this page to us,
- Retain the original engagement letter and the client copy of this letter for your files.

By: _____ Date: _____
(Signature)

_____
(Name, Printed)

_____
(Title)

ATTACHMENT 4-I

ANNUAL RD COMPLIANCE AUDIT TO BE CONDUCTED IN CONNECTION WITH THE ANNUAL FINANCIAL STATEMENT AUDIT

Background – This section contains the U.S. Department of Agriculture, Rural Development's (RD) requirements for conducting the compliance portion of the annual financial audits of profit-motivated entities participating in RD's housing programs.

Compliance Procedures – See Attachment 4-J, Compliance Requirements and Audit Areas of this Chapter: Financial Management.

Major Program Determination/Defined – **Attachment 4-G** of Chapter 4: Financial Management has been developed to assist auditors on how to determine a major program in For-profit entities. Major program is defined as an individual assistance program for which expenditures equal or exceeded $500,000 during the applicable year.

Special Note on RD Rental Assistance, Major Program Determination and Reporting. For RD projects that have determined that RD Rental Assistance is a major program, no additional testing or reporting (such as testing of a tenant file, review of the recertification forms, etc.) is necessary for the rental assistance program.

Non-Major Program Testing – Under this attachment, there are no requirements to test non-major programs.

Group Project-Based Testing - RD prohibits the use of Group Project Based Testing as allowed and defined by the HUD audit guide.

Instances of Non-Compliance – All material instances of non-compliance should be reported as finding in the Schedule of Findings and Questioned Costs. However, non-material non-compliance must be reported to management in writing and must be referenced in the auditor's report by name and the actual or planned date of issuance. A copy of this letter may be requested by RD at its discretion.

Test of Controls Over Compliance – The auditor is required to test controls over compliance.

Attribute Sampling – Applies to all testing performed for the compliance component of an audit performed under this section. When planning to test a particular sample of transactions, the auditor should consider the specific audit objective to be achieved and determine whether the audit procedure or combination of procedures to be applied will achieve that objective. The size of a sample is necessary to provide sufficient evidential

matter depends on both the objectives and the efficiency of the sample. All material instances of non-compliance, including those identified through sampling, must be reported as findings in the audit report.

Determining Test Objective, Defining the Population, and Defining an Exception

Before testing begins, the auditor must understand and document what attributes and assertions are being tested. The auditor needs to identify and document the appropriate population and should also perform procedures (for example, reconciliations or inquiry) to ensure that the population from which the sample is selected is complete.

Each compliance requirement selected for testing should be considered a separate population, and samples should be selected accordingly. The sample selected could possibly be used to test multiple attributes within each compliance requirement. Additionally, auditors must assess the control environment at entities with multiple locations. If controls at the different locations are significantly different, each location must be considered a separate population.

The auditor must document the "sampling unit," which is the individual item subject to sampling in the population. When selecting the sample of individual items, auditors must ensure that the sample is representative of the universe for the compliance requirement being tested.

The auditor should also clearly define what would be considered an exception. A single exception would indicate non-compliance, subject to further determination of materiality necessary to determine the required method of reporting.

Determining the Sample Size

To determine attribute testing sample sizes, the auditor needs to determine the value for three inputs: desired confidence level, tolerable exception rate, and expected exception rate. The compliance sample size table below is based on the following assumptions:

- **Desired Confidence –** Auditors should obtain the appropriate level of assurance by using a confidence level of 90 or 95 percent.
- **Tolerable Exception Rate –** A 5-10 percent exception rate is acceptable.
- **Expected Exception Rate –** No exceptions should be expected.
- **Materiality –** Using attribute testing, monetary materiality, or tolerable misstatement is not a necessary input for determining sample size.

Sample Size Table

Using the above considerations and standard attribute sampling methodology, a low to normal level of assurance can be obtained by applying a 90 percent confidence level when there is an expectation of an error rate between 0 and 5 percent. The minimum recommended sample size using these parameters at a 5 and 10 percent tolerable exception rate is 50 and 25, respectively. Similarly, using a 95 percent confidence level, an expected error rate between 0 and 5 percent, and a 5 or 10 percent tolerable exception rate, the sample size is 65 and 35, respectively. These sample sizes are shown in the table below.

Compliance sample size table

Importance or significance of the attribute being	Confidence level	Tolerable rate	Minimum sample size for populations
Low to normal	90%	5%	50
Low to normal	90%	10%	25
High	95%	5%	65
High	95%	10%	35

This table is illustrative and does not replace professional judgment. As noted in the table, these are minimum sample sizes, and there may be many situations in which the auditor should also consider qualitative factors when determining sample size. Factors indicative of higher risk include but are not limited to:

- Whether this is the initial audit of the entity performed by the auditor.
- The entity's size and level of decentralization. The existence of a large number of prior, significant deficiencies, material weaknesses, or other audit findings.
- Poor internal controls.
- Extremely high volume of activity relating to a particular compliance requirement.
- High employee turnover in a particular area or department.

If the initial sample does not include a particular attribute being tested, typically there would be a need to have additional items included in the sample to address only that specific attribute.

Each compliance test performed should be evaluated separately for purposes of determining sample size. Professional judgment should be used to determine what tests are considered low versus high risk. When making the risk determination, it is important to understand the nature of the population.

Populations of 250 Items or Fewer

When performing compliance testing of populations of 250 items or fewer, auditors generally should examine at least 10 percent of the items in the population. This is a minimum sample size, and qualitative factors may exist that would require a larger sample size.

Testing and Evaluating Results

The sample sizes in the table above are based on an expectation of no exceptions. If the testing performed discovers no exceptions, the auditor has achieved a high degree of confidence that the attribute or assertion is being performed at an acceptable level.

If there are observed exceptions, the auditor should investigate the nature and cause of the exceptions to determine whether the exceptions are immaterial or represent material compliance findings or significant deficiencies or material weaknesses in internal control. It is not necessary to expand testing when exceptions are found.

In cases in which an exception is found, the auditor must determine whether the individual exception is material enough to report as a compliance violation. The auditor should also consider whether the lack of an effective internal control constitutes a significant deficiency or a material weakness and document the basis for an unqualified opinion if a finding is determined to be a significant deficiency or material weakness.

Audit Documentation

Documentation of sampling procedures must include the test objective, the definition of an exception, a description of the population tested and the sampling unit, the confidence level, the significance of the attribute, the sample size, and the results of testing.

Technical Assistance

Technical guidance on audit sampling is available in the AICPA's Audit Guide for Government Auditing Standards. Auditors may substitute an approach from the AICPA's audit guide for the approach described above, provided that the resulting sample size is equal to or greater than the above minimum sample sizes.

ATTACHMENT 4-J
COMPLIANCE REQUIREMENTS AND AUDIT AREAS

The following sections within this Attachment contain suggested audit procedures that RD believes should be performed. If an auditor determines that the stated procedures to be inappropriate and/or other audit procedures should be performed, the deviation from the stated procedures must be justified and documented in the auditor's working papers. The term "Owners" is utilized throughout this Attachment to refer to Borrowers, Projects, Entities, etc.

A. *Mortgage Status.*

1. **Compliance Requirement.** Owners shall promptly make all payments due under the note and mortgage.

2. ***Suggested Audit Procedures.***

   a. Obtain a copy of the mortgage note, mortgage (or deed of trust), and associated loan amortization schedule to determine the terms and conditions of those agreements.

   b. Obtain an understanding of the Owner's procedures for assuring prompt payment of the mortgage.

   c. If the project is operating under a mortgage modification agreement, workout agreement, forbearance agreement, use agreement, or other agreement, determine whether the Owner is complying with the terms and conditions of the agreement.

B. *Replacement Reserve.*

1. **Compliance Requirement.** Owners, as required, shall establish a reserve for replacement account and make deposits in accordance with RD requirements, usually the loan agreement or other similar business agreement. Disbursements from the reserve for replacement fund may be made only after written consent is received from RD.

2. ***Suggested Audit Procedures.***

   a. Obtain an understanding of the Owner's deposit and maintenance requirements included in the loan agreement, business agreement and any amendments or other written agreements with RD and determine whether there were any changes to the funding requirement by obtaining and reviewing Multi-Family Information System (MFIS) Project Reserve CheckBook Authorization (FIN 2100).

b. Obtain an understanding of the Owner's procedures for depositing, maintaining, requesting, and disbursing reserve for replacement funds.

c. Verify the yearend balance of the replacement reserve. In addition to the verification of the balance, verify with the financial institution that no encumbrances are being held on the reserve account.

d. Determine whether all disbursements from the reserve for replacement account were properly authorized by RD.

e. Determine whether the reserve fund has been established in a federally insured depository.

f. RD requires funds to be invested, determine whether funds were invested and interest was only withdrawn with RD approval.

g. Using the FIN 2100 Report, verification of the account balance and the approved withdrawals, determine whether all required deposits to the reserve for replacement were made in compliance with RD requirements and agreements and the project is on schedule with its funding requirements.

h. Review the related repairs covered by funds from the reserve for replacement account. Trace the reserve withdrawal amount to cancelled invoices and cancelled checks or check images to determine whether funds were used for the purpose authorized by RD.

C. ***Return on Investment (ROI) or Return to Owner (RTO)s.***

1. **Compliance Requirement.** Owners may not make, receive, and/or retain any distribution of assets or any income of any kind unless the project has positive net cash flow per Form RD 3560-7 "*Multiple Family Housing Project Budget,"* line 30. This process is further defined in this Chapter.

2. ***Suggested Audit Procedures.***

a. Obtain a copy of the project's loan agreement, business agreements and any amendments or associated documents to determine the owner's rights for receiving distributions.

b. Obtain an understanding of the Owner/management agent's procedures for determining the cash available for making distributions.

c. Scan minutes of board or partnership meetings for discussions authorizing distributions.

d. Question the Owner or management agent about the existence of any notices of default or other items of non-compliance under any of the terms of the loan or business agreement.

e. Determine whether the Form RD 3560-7 was prepared in accordance with the loan or business agreement and other RD guidance.

f. Determine whether distributions taken during the audit period exceeded the amounts calculated and/or authorized for that period based on the loan or business agreements, including any amendments.

g. Scan cash disbursements for evidence of any payments made to the Owner or related parties. Scan journal entries for unexplained decreases in accounts payable, notes payable, and the related unpaid interest to the Owner or related parties. Determine whether the owner paid partnership management fees, asset management fees, incentive management fees, and write-offs of related party receivables from funds other than allowable distribution amounts.

h. Scan the bank statements for any deposit, from the Owner and/or related parties, which would evidence that incorrect distributions or payments were made and that those funds were redeposited into the project's accounts during the year under audit.

i. Review inspection reports and Owner responses to verify compliance with all outstanding Notices for proper maintenance of the project. Delays in making repairs could erroneously result in excess operating cash being reported to be on hand at the end of the reporting period, making funds available for distribution to the Owners.

j. With Agency approval, Owners operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year. The borrower uses Form RD 3560-12, requesting the withdrawal and must provide documentation of the prior year interest earned.

D. *Equity Skimming.*

1. **Compliance Requirement.** Equity skimming is the willful misuse of any part of the rent, assets, proceeds, income, or other funds derived from the project covered by the mortgage for any purpose other than to meet actual or necessary expenses of the project. Equity skimming deprives the project of needed funds for repairs, maintenance, and improvements, which contributes to the financial and physical deterioration of the project and the standard of living conditions for the families who depend on the federal government to provide housing. Also, a community where the project is located suffers since the project may become the breeding ground for crime, violence, and drugs.

2. **Suggested Audit Procedures.** The various compliance areas in this Attachment have included audit steps that are designed to disclose equity skimming.

E. *Cash Receipts.*

1. **Compliance Requirement.** All cash receipts, including those collected by a management agent, must be deposited into an account in the name of the project at an institution in which deposits are federally insured.

2. ***Suggested Audit Procedures.***

   a. Obtain an understanding of the Owner/management agent's procedures for handling cash receipts.

   b. Determine whether the account is exclusively in the name of the project.

   c. Verify that cash receipts are maintained in an FDIC account.

   d. Obtain the monthly project worksheets and determine the net tenant rent and rental assistance are reasonable compared to amounts recorded in the general ledger.

   e. Owners may be motivated to both understate and overstate revenue. The following audit steps are designed to disclose such occurrences:

      (1) Consider the fraud risk factors and the potential for material misstatement of the financial statements related to revenue recognition including vacancy loss and bad debt expense. Perform testing to address any material fraud risk factors identified. The auditor should tailor audit steps/procedures based on the individual risk factors identified and the results of other audit evidence gathered.

(2) Determine whether vacancy loss is greater than 15 percent of total rental revenue or if the change in vacancy loss between the current year and prior year is greater than 5 percent. If so, the following steps should be performed:

i. Determine whether rent potential and vacancy loss were properly calculated.

ii. For all revenue accounts, scan the detailed general ledger. Review the supporting documentation for all material manual entries and unusual entries.

iii. Determine the reason for the increase or cause of the high vacancy rate via discussion with management. The auditor may also want to select a sample of vacant units and perform tests to substantiate the high vacancy rate. Possible tests on the sample include but are not limited to the following:

(i) Reviewing the move-out notice from the tenant.

(ii) Reviewing the documentation from the move-out inspection.

(iii) Determining whether the security deposit was refunded to the tenant.

(iv) Reviewing the itemized list of damages and charges provided to the tenant, which was used to reduce the amount of security deposit due back to the tenant.

(v) Inspecting the vacant unit if the unit is still unoccupied.

(vi) Questioning site personnel, including the resident manager and the building manager, to determine the period when the unit was vacant.

(vii) Reviewing work orders to determine the period when the unit was vacant.

(3) Determine whether bad debt expense is greater than 10 percent of total rental revenue or whether the change in bad debt expense is greater than 5 percent between the current year and the prior year. If so, the following steps should be performed:

i. Obtain an understanding of the owner/management agent's procedures for collecting delinquent debt and policy for writing off debt.

ii. Determine whether delinquent accounts are sufficiently pursued according to procedures.

iii. Select a sample of accounts written off to bad debts expense and review supporting documentation to determine whether debt was written off in accordance with policy and generally accepted accounting principles.

iv. Determine the reason for any activity on the tenant record after the debt was written off.

F. ***Cash Disbursements.***

1. **Compliance Requirement.** All disbursements from the regular operating account must be supported by approved invoices, bills, or other supporting documentation. Project funds should only be used to pay for mortgage payments, required deposits to the reserve for replacement fund, reasonable expenses necessary for the operation and maintenance of the project, distributions, as permitted, and repayment of owner advances or as authorized by RD.

2. ***Suggested Audit Procedures.***

   a. Obtain an understanding of the Owner/management agent's procedures for withdrawing funds from the regular operating account and determine whether they are properly supported and used in accordance with the loan agreement.

   b. Select a sample of disbursements from the cash disbursement ledger or similar record related to Form RD 3560-7, Part II, line items 1-10 and 19-32 and perform the following steps:
      (1) Determine whether the disbursements are supported by approved invoices, bills, or other supporting documentation; the supporting documents are in the name of the project; and the costs are reasonable and necessary for the operation of the project. If the supporting documentation is not in the name of the project, determine whether only the portion applicable to the project was paid from project funds.
      (2) Determine whether the disbursements were made on behalf of other projects or entities since project funds cannot be loaned or used for non-project purposes. Report instances even if amounts have been repaid prior to the issuance of the audit report unless clearly inconsequential and was discovered in the normal course of internal control processes.
      (3) Determine whether the disbursements were properly charged to the correct account.
      (4) Determine whether the disbursement sampled items were allowable eligible project expenses (Attachment 4-C).

G. ***Tenant Security Deposits.***

1. **Compliance Requirement.** Funds collected as a security deposit shall be kept in the name of the project, separate and apart from all other funds of the project in a trust account. The amount of this account shall always equal or exceed the aggregate of all outstanding obligations under that account. In addition, state and local governments may have specific regulations governing the handling of tenant security deposits.

2. ***Suggested Audit Procedures.***

a. Obtain an understanding of the Owner's procedures, including state and local laws, and regulatory agreement and RD requirements for establishment and maintenance of the security deposit account and making approved disbursements from that account.

b. Determine whether the account has been established in a federally insured depository in the name of the project, which is segregated from project operating funds, and the owner's records support the amount on deposit.

c. Determine whether interest is earned on the security deposit account and the disposition of that interest. If state and local law requires the owner to pay the tenant for interest earned, determine that the tenant interest is credited to tenants and paid upon termination of tenancy.

H. Management Functions.

1. **Compliance Requirement.** The Owner is responsible for complying with all requirements of the regulatory and loan agreements. *The Owner may perform all management functions or contract with a management agent to provide project management, but the responsibility cannot be delegated to the management agent. The owner or management agent must be approved by RD and must certify that it will follow RD's rules and regulations.

2. ***Suggested Audit Procedures.***

a. Obtain a copy of the most recent RD-approved management agent's certification Form RD 3560-13. Perform the following steps:

(1). Determine whether RD has approved the Owner or current management agent.

(2). Obtain the identity-of-interest (IOI) disclosure certificate Form RD 3560-31 from the owner or RD and that the IOI's have been reported in the notes to the financial statements.

(3). Using the Form R D 3560-31, examine a sample of invoices from IOI companies and determine that the actual services and fees charged to the project were approved and properly supported.

(4). Determine whether the management agent fees paid exceeded the amount listed on the management agent certification. This amount should also agree with the amount in the management agreement.

b. Determine whether the Owner or the management agent has obtained a fidelity bond in accordance with 7 CFR 3560.105.

c. Determine whether hazard insurance has been obtained in the amount required by the project's mortgage.

d. Determine whether the Owner or management agent has responded to all RD management review reports, physical inspection reports, and inquiries regarding annual financial statements or monthly accounting reports within 30 days.

I. Unauthorized Change of Ownership/Acquisition of Liabilities.

1. Compliance Requirements. Owners shall not, without the prior written consent of RD, convey, assign, transfer, dispose of, or encumber any of the mortgaged property or permit the conveyance, transfer, or encumbrance of such property.

2. Suggested Audit Procedures.

a. Question management about the existence of any agreements to sell, assign, dispose of, or encumber any of the mortgaged property or assets of or beneficial interest* in the property. Review any agreements. Determine whether RD has approved transactions or is in the process of approving transactions and report any instances of non-compliance.

b. Confirm all material liabilities listed on the client's balance sheet. Review for indications of change of ownership or additional encumbrances that may have been made without RD approval.

c. Report any other instances of unauthorized conveyance, assignment, transfer, disposal, or encumbrance of any of the mortgaged property or assets of or beneficial interest* in the property identified during the course of the audit.

J. Unauthorized Loans of Project Funds.

1. Compliance Requirements. Owners shall not, without the prior written consent of RD, assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except for reasonable operating expenses and necessary repairs.

2. Suggested Audit Procedures.

a. Question management about the existence of any agreements to assign, transfer, dispose of, or encumber any of the personal property of the project, including rents, and read any agreements.

b. Review the results of the audit procedures applied to specific accounts or other general procedures to identify the existence of any unauthorized transactions.

c. Test accounts receivable to determine whether receivables are the result of routine operations and whether project funds have been loaned to the management agent, other projects, employees, or the owner.

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* Beneficial interest is generally the right to profits from an estate or property without owning the estate or property.

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ATTACHMENT 4-K
EXAMPLE INDEPENDENT ACCOUNTANTS' COMPILATION REPORT ON RD PRESCRIBED FORMS

Note – Subject to change based on the most recent professional literature and guidance. It is the accountant's responsibility to use the most up to date language.

INDEPENDENT ACCOUNTANT'S COMPILATION REPORT

ABC LIMITED PARTNERSHIP
DBA ABC APARTMENTS
RD PROJECT NO: 00-000-000000000
COMPILATION OF PRESCRIBED FORMS
(WITH SUPPLEMENTAL INFORMATION)
AND INDEPENDENT ACCOUNTANT'S COMPILATION REPORT
DECEMBER 31, 20xx

ABC Limited Partnership
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To the Partners of ABC Limited Partnership
City, State

Management is responsible for the accompanying financial statements of ABC Limited Partnership (a limited partnership), which comprise the balance sheet as of December 31, 20XX, and the related statements of income for the year then ended, included in the accompanying prescribed forms in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements included in the accompanying prescribed forms nor was I (were we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on the financial statements included in the accompanying prescribed form.

The financial statements included in the accompanying prescribed forms are presented in accordance with the requirements of the U.S. Department of Agriculture, Rural Development, and are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America.

The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was subject to my (our) compilation engagement. I (We) have not audited or reviewed the supplementary information and do not express an opinion, a conclusion, nor provide any assurance on such information.

This report is intended solely for the information and use of the management of ABC Limited Partnership and the U.S. Department of Agriculture, Rural Development and is not intended to be and should not be used by anyone other than these specified parties.
Firm Name
City, State

Report Date

Form RD 3560-10
Multi-Family Housing Borrower Balance Sheet

See Independent Accountant's Compilation Report

Form RD 3560-7
Multi-Family Housing Project Budget

See Independent Accountant's Compilation Report

ABC Limited Partnership

SUPPORTING DOCUMENTATION TO RD FORMS 3560-10 AND 3560-7

Year ended December 31, 20XX

Accounts receivable (Form 3560-10, line 7)	
Accounts receivable - tenants	$ -
Accounts receivable - subsidy	-
Accounts receivable - other	-
	$ -
Notes payable - current detail (Form 3560-10, line 23)	
Prepaid rents	$ -
Accrued compilation fees	-
Accrued real estate taxes	-
Construction loan	-
Bridge loan	-
ABC loan	-
	$ -
Other detail (Form 3560-10, line 27)	
Due to partners	$ -
Development fee payable	-
	$ -
Accrual to cash adjustment (Form 3560-7, line 32)	
Accounts receivable	$ -
Accounts payable	-
Prepaid rent	-
Property management fee	-
Tenant security deposit	-
	$ -

See Independent Accountant's Compilation Report.

ATTACHMENT 4-L

OWNER CERTIFIED
PRESCRIBED FORMS
On the accrual method of accounting
Include RD Forms 3560-10 and 3560-7 and
SUPPORTING DOCUMENTATION SCHEDULES

1. Accounts Receivable (Form RD 3560-10, Line 7)	**Yr XXXX**	**Yr XXXX**
Accounts Receivable - Rental Subsidy	$ -	$ -
Accounts Receivable - Tenants	-	-
Accounts Receivable - Other	-	-
2. Notes Payable (Form RD 3560-10, Line 23)		
Accrued Mortgage Interest	$ -	$ -
Accrued Real Estate Taxes	-	-
Prepaid Rents	-	-
3. Other (Form RD 3560-10, Line 27)		
Due to Partners		$ -
4. Miscellaneous (Form RD 3560-7, Line 27)		
Bad Debts		$ -
Other	–	-
5. Accrual to Cash Adjustment (Form RD 3560-7, Line 32)		
Assets		
Accounts Receivable $	-	-
Accounts Receivable - Other	-	-
Prepaid Expenses	-	-
Security Deposits	-	-
Liabilities		
Accounts Payable - Trade	-	-
Accrued Real Estate Taxes	-	-
Security Deposits & Prepaid Rents	-	-
Other Adjustments	-	-
20XX Mortgage Payment made in 20XX	-	-

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ATTACHMENT 4-M
EXAMPLE REPORTS

1. Independent Auditor's Report

2. Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

3. Independent Auditor's Report on Compliance For Each Major RD Program and Internal Control Over Compliance required by the Audit Guide for Audits of RD Programs

Note – Subject to change based on most recent professional literature and guidance. It is the auditor's responsibility to use the most up to date language.

Audited Financial Statements
With Required Rural Development
Supplemental Information

ABC Apartments, LP

RHS Project Number: 00-000-000000000-00-0

December 31, 20x2 and 20x3

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

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Independent Auditor's Report

To the Partners of
ABC Apartments, LP
New York, New York

USDA Rural Development
Servicing Office
New York, New York

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Apartments, LP RHS Project No. 00-000-000000000-00-0 (Partnership), which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income (loss), changes in partners' capital (deficit), and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Partnership's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Partnership's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Partnership as of December 31, 20X2 and 20X1, and the results of its operations, changes in partners' capital (deficit), and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information is presented for purposes of additional analysis as required by the *United States Department of Agriculture Rural Development.*

Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Reports Issued in Accordance with *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated March XX, 20X3 on our consideration of Partnership's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Partnership's internal control over financial reporting and compliance.

ABC Firm, LLC

Indianapolis, Indiana

March XX, 20X3

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Balance Sheets
December 31, 20X2 and 20X1

The accompanying notes are an integral part of the financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Balance Sheets (continued)

December 31, 20X2 and 20X1

LIABILITIES AND PARTNERS' CAPITAL (DEFICIT)

	20X2	20X1
Current Liabilities		
Accounts payable - operations	$ -	$ -
Accrued mortgage interest	-	-
Accrued real estate taxes	-	-
Mortgage payable - current portion	-	-
Deferred revenue	-	-
Total current liabilities	-	-
Tenant Deposits Held In Trust		
Tenant deposits held in trust	-	-
Long-Term Liabilities		
Mortgage payable, net of current portion	-	-
Due to related parties	-	-
Total long-term liabilities	-	-
Total Liabilities	-	-
Total Partners' Capital (Deficit)	-	-
Total Liabilities and Partners' Capital (Deficit)	$ -	$ -

The accompanying notes are an integral part of the financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Statements of Income (Loss)
For the Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rental Income		
Tenant payments	$ -	$ -
Tenant assistance payments	-	-
Total potential rental income	-	-
Vacancies	-	-
Total rental income	-	-
Other Income		
Interest income	-	-
Laundry and vending	-	-
Tenant charges	-	-
Other income	-	-
Total other income	-	-
Total income	-	-
Expenses		
Maintenance and operating	-	-
Utility	-	-
Administrative	-	-
Tax and insurance	-	-
Total expenses	-	-
Income from Operations	-	-
Non-Operating Income (Expense)		
Interest subsidy income	-	-
Interest expense	-	-
Depreciation expense	-	-
Total non-operating income (expense)	-	-
Net Income	$ -	$ -

The accompanying notes are an integral part of the financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Statements of Changes in Partners' Capital (Deficit)
For the Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Partners' Capital (Deficit), Beginning of Year	$ -	$ -
Net Income	-	-
Distributions	-	-
Partners' Capital (Deficit), End of Year	$ -	$ -

The accompanying notes are an integral part of the financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Statements of Cash Flows
For the Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Reconciliation of Net Income to Net Cash Provided by Operating Activities		
Net Income	$ -	$ -
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities		
Depreciation expense	-	-
Decrease (increase) in assets		
Prepaid expenses	-	-
Tenant deposits held in trust	-	-
Increase (decrease) in liabilities		
Accounts payable - operations	-	-
Accrued mortgage interest	-	-
Accrued real estate taxes	-	-
Tenant deposits held in trust	-	-
Net Cash Provided By Operating Activities	-	-
Cash Flow From Investing Activities		
Net withdrawals from the reserve for taxes and insurance	-	-
Purchase of fixed assets	-	-
Net Cash Used In Investing Activities	-	-
Cash Flow from Financing Activities		
Principal payments	-	-
Payments on deferred revenue	-	-
Proceeds on deferred revenue	-	-
Distributions	-	-
Net Cash Used In Financing Activities	-	-
Increase (Decrease) in Cash and Cash Equivalents	-	-
Cash and Cash Equivalents, Beginning of Year	-	-
Cash and Cash Equivalents, End of Year	$ -	$ -
Supplemental Disclosure		
Cash paid for interest	$ -	$ -

The accompanying notes are an integral part of the financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Notes to the Financial Statements
For the Years Ended December 31, 20X2 and 20X1

Note 1 – Nature of Activities

ABC Apartments, LP RHS Project No. 00-000-000000000-00-0 (Partnership) was formed on June 1, 1908, under the laws of the State of New York, for the purpose of operating a XX-unit apartment community located in New York, New York. The community is financed by a United States Department of Agriculture Rural Development (RD) Section 515 Loan, and therefore is regulated by RD as to rent charges and operating methods. Under this program, Partnership provides housing to low-income and moderate-income families, subject to regulation by RD as to rental charges and operating methods. Lower rental charges to tenants are recovered by Partnership through rental and interest subsidies provided by RD.

Note 2 – Significant Accounting Policies

A summary of Partnership's significant accounting policies consistently applied in the preparation of the accompanying financial statements is as follows:

Basis of Accounting

Partnership's financial statements were prepared on the accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of continent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, and other changes in partners' capital (deficit) during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the statements of cash flows, all unrestricted investment instruments with original maturities of three months or less are cash and cash equivalents. As of December 31, 20X2 and 20X1, cash and cash equivalents consist of an operating checking account.

Subsequent Events

Partnership evaluated subsequent events through March XX, 20X3, which is the date the financial statements were available to be issued. This evaluation determined that there are no subsequent events that necessitated further disclosure in and/or adjustments to the accompanying financial statements.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Note 2 – Significant Accounting Policies (continued)

Tenant Receivable and Bad Debt
Tenant rent charges for the current month are due on the first of the month. Tenants who are evicted or move out are charged with damages or cleaning fees, if applicable. Tenant receivable consists of amounts due for rental income, security deposits, or the charges for damages and cleaning fees. Partnership does not accrue interest on the tenant receivable balances.

Partnership has not established an allowance for doubtful accounts and does not use the reserve method for recognizing bad debts. Bad debts are treated as direct write-offs in the period management determines that collection is not probable.

Tenant Security Deposits
Partnership maintains accounts for security deposits received from tenants. The cash is restricted for reimbursement of the security deposits unless there is evidence of default by a tenant under the lease agreement.

Tax and Insurance Reserve
Tax and insurance reserve is restricted cash for payments of real estate taxes and insurance. Partnership is required to establish and maintain a reserve account. This account is used to receive monthly deposits sufficient to pay annual real estate taxes and insurance premiums that are paid from the account.

Replacement Reserves
In accordance with the loan agreement with RD, a reserve for replacement is to be funded $AMT annually until it reaches $AMT.

Property and Equipment
Property and equipment are recorded at cost. Depreciation is computed using the straight-line method of depreciation. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized as income or loss for the period. The cost of maintenance and repairs is charged to expense as incurred and significant renewal and betterments are capitalized. Deductions are made for retirements resulting from renewals or betterments.

Accrued Real Estate Taxes
Partnership is subject to real estate and personal property taxes and pays one year in arrears. Partnership was assessed in 20X1 and made bi-annual payments in May 20X2 and November 20X2. Failure to make these payments could have resulted in additional penalties, interest, and liens. At December 31, 20X2 and 20X1, accrued real estate taxes represent an estimated amount to be paid in the subsequent year.

Recognition of Rent Revenue
Partnership recognized net rent revenue in the period in which the rent is earned. In accordance with the RD financial reporting requirements, potential rental income represents total possible rent revenue as if all units are 100 percent occupied during the year. Total rental income represents potential rental income less vacancies. Rents collected in advance are deferred until the rental income is earned.

ABC Apartments, LP
RHS Project No. 00-000-000000000-00-0

Note 2 – Significant Accounting Policies (continued)

Rental Assistance Payments

Partnership entered into a rental assistance contract for low-income families as provided by RD.

Advertising

Partnership expenses advertising costs as they incur. For the years ended December 31, 20X2 and 20X1, advertising and marketing expenses were $AMT and $AMT, respectively.

Income Taxes

No provision for federal or state income taxes was made in the financial statements as the federal and state income tax effect on Partnership's activities accrued to its partners.

Generally accepted accounting principles in the United States require Partnership to examine its tax positions for uncertain positions. Partnership is not aware of any tax positions that are more likely than not to change in the next twelve months, or that would not sustain an examination by applicable taxing authorities. Partnership's policy is to recognize penalties and interest as incurred in its statements of income (loss) as a component of operating expenses, and totaled $0 for December 31, 20X2 and 20X1. Partnership's federal and state income tax returns for fiscal years ended 20XX through 20XX are subject to examination by the applicable tax authorities, generally for three years after the later of the original or extended due date.

Impairment of Long-Lived Assets

In accordance with the provisions of accounting for the impairment or disposal of long-lived assets, Partnership reviews long-lived assets for impairments when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of an asset may not be recoverable, a write-down to fair value is recorded. Fair values are determined based on the discounted cash flows, quoted market values, or external appraisals, as applicable. Long-lived assets are reviewed for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified.

Fair Value Measurements

Partnership adopted fair value measurements of financial assets and financial liabilities of non-financial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. This establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements).The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that Partnership has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

ABC Apartments, LP RHS
Project No. 00-000-000000000-00-0

Note 2 – Significant Accounting Policies (continued)

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Partnership had no investments at December 31, 20X2 and 20X1 except for certificate of deposits.

Partnership operates in a heavily regulated environment that typically includes restrictions such as land use, rent regulations, government subsidies in the form of rental assistance through either rent subsidy or tenant vouchers, subsidized mortgage interest rates, and restrictions on selling or transferring.
A summary of the methods and significant assumptions used to estimate the fair values of financial instruments is as follows:

- Short-term financial instruments – The fair value of short-term financial instruments, including cash and cash equivalents, restricted deposits, accounts receivable, accounts payable and accrued liabilities approximate their carrying value due to the short-term nature of these instruments.
- Long-term financial instruments – The fair value of long-term financial instruments, including mortgage payable which approximates the carrying value in the accompanying financial statements based on current borrowing rates.

Reclassifications
Certain accounts in the 20X1 financial statements were reclassified for comparative purposes to conform with the presentation in the 20X2 financial statements. Total assets, liabilities, partners' capital (deficits), and net income are unchanged due to these reclassifications.

Note 3 – Mortgage Payable
The mortgage payable is payable to RD in monthly installments of $AMT at an interest rate of RATE% per annum and a term of # years, maturing on DATE. As part of the Loan Agreement, Partnership entered into an Interest Credit and Rental Assistance Agreement that effectively lowers the interest rate to approximately 1 percent over the term of the loan. The mortgage liability of Partnership is limited to the underlying value of the real estate collateral pledged. No partner is personally liable on the mortgage note payable. The original amount of the note payable was $AMT.

Estimated annual maturities of the mortgage notes payable are as follows:

20X3	$ AMT
20X4	AMT
20X5	AMT
20X6	AMT
20X7	AMT
Thereafter	AMT
	$ AMT

ABC Apartments, LP RHS
Project No. 00-000-000000000-00-0

NOTE 4 – DISTRIBUTION TO PARTNERS
Under the mortgage payable agreement, annual distributions to partners are limited by RD regulations to $AMT. During the years ended December 31, 20X2 and 20X1, $AMT and $AMT, respectively were distributed to the partners. Distributions are paid one year in arrears of being earned.

Note 5 – Related Party Transaction

Management Fee
Partnership entered into a management agreement with ABC Property Management (management agent), an identity of interest with the general partner, to manage the rental operations. The management agreement allows for a management fee based on per occupied unit per month. Property management fees were $AMT and $AMT during the years ended December 31, 20X2 and 20X1, respectively.

Management Services
Management agent provides administrative services to Partnership and was reimbursed $AMT and $AMT for the cost of site employee payroll, payroll taxes, and benefits during the years ended December 31, 20X2 and 20X1, respectively.

Legal Services
ABC Legal, an identity of interest with the general partner, performs legal services for Partnership. During the years ended December 31, 20X2 and 20X1, $AMT and $AMT, respectively, was incurred and expensed.

Advances from General Partner
A general partner made non-interest-bearing operating deficit loans of $AMT which are payable from the proceeds of the sale or refinancing of the rental property. At December 31, 20X2 and 20X1, Partnership owes the general partner $AMT and $AMT, respectively.

Note 6 – Current Vulnerability Due to Certain Concentrations

Concentration in Affordable Housing Market
Partnership's sole asset is ABC Apartments. Partnership's operations are concentrated in the affordable housing real estate market. In addition, Partnership operates in a heavily regulated environment. The operations of Partnership are subject to the administrative directives, rules, and regulations of federal, state, and local regulatory agencies, including, but not limited to, RD and the State Housing Agency. Such administrative directives, rules, and regulations are subject to change by an act of Congress or an administrative change mandated by RD or the State Housing Agency. Such changes may occur with little adequate funding to pay for the related cost, including the additional administrative burden, to comply with a change.

Concentration in Government Funding
Partnership received X percent and X percent of gross revenue from RD in the form of rental assistance and interest reduction subsidy payments during the years ended December 31, 20X2 and 20X1, respectively.

Concentration in Credit Risk
Partnership continually monitors its positions with, and the credit quality of, the financial institutions with which it invests. Financial instruments that potentially subject the company to concentration of credit risk consist principally

of cash. Management believes Partnership placed all cash with high-credit quality financial institutions and that there is no significant concentration of credit risk with respect to cash.

ABC Apartments, LP RHS

Project No. 00-000-000000000-00-0

Schedule of Required Supplemental Information
For the Year Ended December 31, 20X2

1. Management Fee Calculation

The management fee is based on a fee per unit occupied by tenants during the month.

Total qualified units	-	
Less: Rent free units	-	
Vacancies	-	
Total occupied units		-
Fee per unit		$ -
Management fee expense		$ -

2. Insurance Disclosure

Partnership maintains insurance coverage as follows:

	Coverage period	Coverage
Property coverage on buildings	November 20X2 to October 20X3	$ -
Fidelity / employee dishonesty	March 20X2 to March 20X3	$ -

3. Return to Owner

In accordance with the loan agreement, the annual return to owner is as follows:

Maximum return to owner	$ -
Budgeted return to owner	$ -
Return to owner paid	$ -

4. Schedule of Changes in Fixed Assets

	Beginning Balance	Additions	Disposals	Ending Balance
Land	$ -	$ -	$ -	$ -
Buildings	-	-	-	-
Furniture and equipment	-	-	-	-
Total fixed assets	$ -	$ -	$ -	$ -
Accumulated depreciation				
Buildings	$ -	$ -	$ -	$ -
Furniture and equipment	-	-	-	-
Total accumulated depreciation	$ -	$ -	$ -	$ -

Fixed asset additions for the year ended December 31, 20X2

None

Fixed asset disposals for the year ended December 31, 20X2

None

See Independent Auditors report

ABC Apartments, LP RHS
Project No. 00-000-000000000-00-0

Schedules of Expenses
For the Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Maintenance and Operating Expenses		
Maintenance and repairs - payroll	$ -	$ -
Maintenance and repairs - supplies	-	-
Maintenance and repairs - contract	-	-
Painting	-	-
Snow removal	-	-
Grounds	-	-
Services	-	-
Annual capital budget	-	-
Other operating expenses	-	-
Total maintenance and operating expenses	$ -	$ -
Utility Expenses		
Electricity	$ -	$ -
Water	-	-
Sewer	-	-
Fuel (Oil/Coal/Gas)	-	-
Garbage and trash removal	-	-
Other utilities	-	-
Total utility expenses	$ -	$ -
Administrative Expenses		
Site management payroll	$ -	$ -
Management fee	-	-
Project audit fee	-	-
Legal expense	-	-
Advertising	-	-
Telephone and answering service	-	-
Office supplies	-	-
Training expense	-	-
Health insurance and other employee benefits	-	-
Payroll taxes	-	-
Workers' compensation	-	-
Other administrative expenses	-	-
Total administrative expenses	$ -	$ -
Taxes and Insurance Expenses		
Real estate taxes	$ -	$ -
Property and liability insurance	-	-
Fidelity coverage insurance	-	-
Total taxes and insurance expenses	$ -	$ -

See Independent Auditors report

ABC Apartments, LP RHS
Project No. 00-000-000000000-00-0

Form RD 3560-10

Multi-Family Housing

Borrower Balance Sheet

See Independent Auditors report

ABC Apartments, LP RHS
Project No. 00-000-000000000-00-0

Form RD 3560-7

Multi-Family Housing

Project Budget

See Independent Auditors report

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Partners of
ABC Limited Partnership
DBA ABC Apartments
City, State

USDA Rural Development
Servicing Office
City, State

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of ABC Limited Partnership, which comprise the balance sheet as of December 31, 20X2, and the related statements of operations, changes in partners' equity and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated DATE, YEAR.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered ABC Limited Partnership's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ABC Limited Partnership's internal control. Accordingly, we do not express an opinion on the effectiveness of ABC Limited Partnership's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ABC Limited Partnership's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of ABC Limited Partnership's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ABC Limited Partnership's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Firm's signature
City, State
DATE, YEAR

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR RD PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE CONSOLIDATED AUDIT GUIDE FOR AUDITS OF RD PROGRAMS

To the Partners of
ABC Limited Partnership
DBA ABC Apartments
City, State

USDA Rural Development
Servicing Office
City, State

Report on Compliance for Each Major RD Program

We have audited ABC Limited Partnership's compliance with the compliance requirements described in the *Audit Guide for Audits of RD Programs* (the Guide) that could have a direct and material effect on ABC Limited Partnership's major U.S. Department of Rural Development (RD) program for the year ended December 31, 20X2. The Partnership's major RD program is as follows:

List the major program.

Name of Major RD Program	Direct and Material Compliance Requirements
Section 515 Rural Rental Housing Loan	Mortgage status, replacement reserve, return on investment or return to owner, equity skimming, cash receipts, cash disbursements, tenant security deposits, management functions, unauthorized change of ownership or acquisition of liabilities and unauthorized loans of project funds.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its RD program.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of ABC Limited Partnership's major RD programs based on our audit of the compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Guide. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the compliance requirements referred to above that could have a direct and material effect on a major RD program occurred. An audit includes examining, on a test basis, evidence about ABC Limited Partnership's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major RD programs. However, our audit does not provide a legal determination of ABC Limited Partnership's compliance.

Opinion on Each Major RD Program

In our opinion, ABC Limited Partnership complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major RD program for the year ended December 31, 20X2.

Other Matters (needs to be included if immaterial instances of non-compliance were noted)

We noted certain matters that we are required to report to management of ABC Limited Partnership in a separate written communication. These matters are described in our management letter dated DATE, YEAR.

Report on Internal Control Over Compliance

Management of ABC Limited Partnership is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit of compliance, we considered ABC Limited Partnership's internal control over compliance with the requirements that could have a direct and material effect on its major RD program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for its major RD program and to test and report on internal control over compliance in accordance with the Guide, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of ABC Limited Partnership's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, non-compliance with a compliance requirement of an RD program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material non-compliance with a compliance requirement of a RD program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a compliance requirement of a RD program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Guide. Accordingly, this report is not suitable for any other purpose.

Firm's signature
City, State
DATE,YEAR

ABC Apartments, LP RHS

Project No. 00-000-000000000-00-0

Schedule of Findings and Questioned Costs
For the Year Ended December 31, 20X2

For the Year Ended December 31, 20X2:

There were no findings or questioned costs for the year ended December 31, 20X2.

For the Year Ended December 31, 20X1:

There were no findings or questioned costs for the year ended December 31, 20X1.

ABC Apartments, LP RHS

Project No. 00-000-000000000-00-0

Schedule of Lead Auditor
For the Years Ended December 31, 20X2 and 20X1

Auditor Information:	ABC Firm, LLC Main Street, Suite 104 New York, New York 10017
Phone Number:	(000) 000-0000
Fax Number:	(000) 000-0000
Auditor Contact:	John Doe, CPA
Auditor Contact Title:	Member
Auditor Contact Email:	Jdoe@ABCfirm.com

Attachment 4-N

Year End Financial Reporting Requirements
State and Local Government, Indian Tribes and Non-Profit Organizations

Single Audit

The Single Audit is divided into two areas: Compliance and Financial.

The compliance component of a Single Audit covers the study and understanding (planning stage) as well as the testing and evaluation (exam stage) of the recipient with respect to federal assistance usage, operations and compliance with laws and regulations

The financial component is exactly like a financial audit of a non-Federal entity which includes the audit of the financial statements and accompanying notes.

Single Audit Component Reference /Checklist

Financial Statement(s) 2 CFR 200.510(a)
Opinion on Financial Statements 2 CFR 200.515(a)
Uniform Guidance Report on Internal Control 2 CFR 200.515(b) (major programs)
Uniform Guidance Report on Compliance 2 CFR 200.515(c) (major programs)
GAS Report on Internal Control 2 CFR 200.515(b)
Schedule of expenditures of Federal Awards 2 CFR 200.510(b) (Example provided)
Opinion or Disclaimer of Opinion on Schedule of Federal Awards 2 CFR 200.515(a)
GAS Report on Compliance 2 CFR 200.515(c)
Schedule of Findings and Questioned Costs 2 CFR 200.515(d) (Example provided)
Summary Schedule of Prior Audit Findings 2 CFR 200.511(b)
Corrective Action Plan (if findings) 2 CFR 200.511(c) (Example provided)

DEF Apartments NFP
Project No. 00-000-000000000-00-0

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year ended December 31, 20X7

Federal Grantor/ (Pass-through Grantor)/ Program Title	Federal CFDA Number	Agency or Pass-through Number	Federal Expenditures
U.S. Departments of Agriculture Rural Rental Housing Loans	10.415		$2,247,033
U.S. Departments of Agriculture Rural Rental Housing Loans	10.427		242,249
U.S. Departments of Agriculture Interest Assistance Programs	10.437		87, 046
Total			$ 2,576,328

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal award activity of DEF Apartments under programs of the federal government for the year ended December 31, 20X7.

The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Project, it is not intended to and does not present the Project's financial position, changes in net assets, or cash flows.

2. Summary of Significant Accounting Policies

(a) Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

(b) DEF Apartments NFP has elected not to use the 10 percent de minimus indirect cost rate as allowed under the Uniform Guidance.

(c) The outstanding balance of loan and loan guarantee programs at December 31, 20x7 with continuing compliance requirements which are reported as federal expenditures on the accompanying schedule of expenditures of Federal Awards was $2,229,088.

See Independent Auditor's Report
.

DEF Apartments NFP
Project No. 00-000-000000000-00-0

SCHEDULE OF FINDINGS
Year ended December 31, 20X7

Financial Statements

Type of auditor's report issued: *Unmodified*

Internal control over financial reporting:
Material weakness identified? _____ Yes __X__ No

Significant deficiency identified not considered
to be material weaknesses? _____ Yes __X__ None

Non-compliance material to financial statements noted? _____ Yes __X__ No

Federal Awards

Type of auditor's report issued on compliance for
major programs:

Internal control over financial reporting:
Material weakness identified? _____ Yes __X__ No

Significant deficiency identified not considered
to be material weaknesses? _____ Yes __X__ None

Any audit findings disclosed that are required to be
reported in accordance with CFR Section
200.516(a)? _____ Yes __X__ No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
10.415	Rural Rental Housing Loans

Dollar threshold used to distinguish between Type A
and Type B programs: $XX0, 0000

Auditee qualified as low-risk auditee? _____ Yes __X__ No

DEF Apartments NFP
Project No. 00-000-000000000-00-0

SCHEDULE OF FINDINGS, QUESTIONED COSTS, AND RECOMMENDATIONS
December 31, 20X7

Findings Financial Statements Audit

None noted

Findings and Questioned Costs Major Award Programs Audit

None noted

Findings and Questioned Costs Prior Years

None noted

ATTACHMENT 4-O
Agency Review of Annual Financial Reports

To be used as a GUIDE to assist in the review and expose areas of risk that may need further scrutiny.

Borrower/Property Name: _____ Year Ending: _____

Number of Units: _____ RA Units _____ Date Received: _____ (complete package)

Amount of Federal financial assistance_____

Borrower Submissions

☐ **Form 3560-7** MFH Project Budget *Actual Expenditures* (Submitted through MINC, unless <8 units)
☐ **Form 3560-10** MFH Borrower Balance Sheet (Submitted through MINC, unless < 8 units))
☐ **Borrower Certification of Performance Standards** (Attachment 4-F)
☐ **Engagement Letter (For-Profit/Limited Profit Borrowers- $500,000 or greater of federal financial assistance)**
For profit entities with less than $500,000 or not for profit type entities with less than $750,000 in Federal assistance with no other required audits, see Section 4.16 D Owners compilation of prescribe forms.
☐ **Independent Accountants' Compilation Report ($500,000 or greater of federal financial assistance)**
☐ **State and Local Governments, Indian tribes and Non-Profit Organization SUBJECT TO 2 CFR 200 Part F**
☐ **Audited Financial Statements** (In accordance with GAGAS and yellow book standards) **(For-Profits Entities) OR:**
☐ **Audited Financial Statements** (In accordance with 2 CFR 200 Part F) **(Non-Profit Organizations)**

Reports to View/Review

☐ Year End Actual Analysis
☐ Year End Actual Management Fee Analysis
☐ Year End Actual Rental Income Analysis
☐ Year End Actual Escrow calculation
☐ FIN2100 - Project Reserve Account Checkbook and Project Outstanding Authorizations
☐ PRJS4200 - Occupancy Trend

Agency Review

☐ Confirm that the engagement was performed by CPA as described in the requirements
If not: send back or provide explanation.
☐ Confirm that the performance standards were certified as described per Attachment 4-F
If not: send back or provide explanation.
☐ Confirm that non-profit and public bodies have submitted any OMB required annual financial statements.
☐ Note any findings identified in the compilation report and determine corrective actions. These would be located in the findings of the audit findings page
☐ Utilize the MFIS analysis tool to perform the preliminary assessment of the financial statements.
☐ Confirm the information submitted to the Agency electronically through MINC on Forms RD 3560-7 and 3560-10 is the same as the forms submitted with the financial reports from the auditor, If not: send back.

Follow-up needed by _____on items in e-mail/letter to borrower dated _____.

(e-mail/letter attached)

COMMENTS:_____

_____

_____

AGENCY REVIEW OF ANNUAL FINANCIAL REPORTS

A. Analysis of actual income and expenses.

- ☐ Using the actual budget submitted in MFIS, review actual income and expenses & note any unexplained variance from projection or historical data
- ☐ RUN Analysis Report – review and explain variances in comments.

B. Account maintenance, tracking, and disclosure.

- ☐ Compare account balances from MFIS, the audit report and borrower certification and confirm that the financial report states that:
  - Required accounts (operating, reserve, tax & insurance, and tenant security deposits) are maintained and tracked separately; ○ Yes ○ No _____
  - Payments from operating accounts are disclosed and accurately represented.
    ○ Yes ○ No _____
  - Have any dramatic, unexplained changes in account balances occurred.
    ○ Yes ○ No _____

C. **Reserve account status.**

- ☐ From the financial report, review the amounts listed for the reserve balance, deposits, and withdrawals
  - Confirm that the financial report states that the reserve account is current and that there are no encumbrances on the reserve account funds
    - If Reserve Account is delinquent is there a Work Out Plan in place or requested?○ Yes ○ No
- ☐ Review Reserve Tracked account with Actuals
  - Does the amount the Agency shows as authorized withdrawals match the amount reported withdrawn on yearend actuals? ○ Yes ○ No _____
  - Is the proper bids been received for work greater than $5,000? ○ Yes ○ No _____
- ☐ The following items are flags and require further analysis:
  - Was Reserve used for operating? ○ Yes ○ No _____
  - Is there less than $1000 balance in the reserve account? ○ Yes ○ No _____
  - Is there less than the deductible (GAP amount) in the account? ○ Yes ○ No _____

D. **Tenant security deposit account status.**

Review tenant security account balance from the financial report
Tenant security deposit balance $_____
Tenant security deposit liability $_____ Overfunded/Underfunded?
Verify tenant security deposits are maintained in a separate account and in accordance with state law.

E. **Payment of return to owner <u>OR</u> Non-Profit Asset Management Fee.**

- ❑ Confirm that the financial report states that the payment of the owner's return was consistent with the terms of the loan agreement or resolution.
  The payment of owner return was:
  - ❑ paid in the amount of $_____ for _____ fiscal year and **<u>was</u>** in accordance with the Agency's requirements
    - Amount allowed from $_____ Net Cash $ ___Excess Cash $___Reserve Account
  - ❑ paid in the amount of $_____ for _____ fiscal year and **<u>was not</u>** in accordance with the Agency's requirements
    - Requested to refund _____
  - ❑ not paid during the reporting year

The payment of Non-Profit Asset Management Fee was:

- ❑ paid in the amount of $_____

- ❑ not more than $7500 per project for certain organizational expenses, such as errors and omissions and actual expenses prorated by the number of Rural Development projects.
- ❑ documented by evidence of allowable expenses.

F. **Insurance status.**

☐ Confirm that the financial report states that all relevant insurance requirements were met.

- ❑ Reasonable expense amount for insurance? ○ Yes ○ No _____
- ❑ List not current. _____

G. **Taxes and other assessments.**

☐ Confirm that the financial report states that taxes and other assessments are current.

- ❑ Expense amount for taxes? _____
- ❑ List any taxes or assessments that are not current. _____

H. **Issues of financial compliance and conditions.**

☐ Confirm in the financial report that any funds used for unauthorized purposes have been repaid.

- ○ Not Applicable
- ○ Yes…Amount Repaid $_____ / What for: _____

I. Payment of management fees.

- ❑ Review Management Analysis in MFIS.
- ❑ Using the actuals in the financial report, confirm that the management fee was paid in accordance with the management certification
- ❑ Confirm management agent is not charging the project for agent expenses.

J. Miscellaneous Review

- ❑ Is all Rental Assistance being utilized? ○ Yes ○ No _____
- ❑ Amount of accounts receivable $_____
  - Is there an itemization attached showing what it includes? ○ Yes ○ No
  - Corrective actions disclosed? ○ Yes ○ No
- ❑ Amount of Accounts Payable $ _____
  - Is there an itemization attached showing what it includes? ○ Yes ○ No
  - Corrective Actions disclosed? ○ Yes ○ No
- ❑ Notes payable $_____ Who to _____ Payment terms $_____
  - Documentation of RD approval ○ Yes ○ No
  - Servicing effort in MFIS with comments? ○ Yes ○ No
- ❑ Is the 3560-10, balance Sheet signed by the borrower/rep and the disinterested third party? ○ Yes ○ No
- ❑ Is there a need for a Work Out Agreement ○ Yes ○ No For what reason? _____
  - If there is a Work Out Agreement, is it being followed? ○ Yes ○ No Does it need to be updated? ○ Yes ○ No Quarterly reports being received? ○ Yes ○ No

K. When done - Update Supervisory Activities in MFIS:

- ❑ 3560-7 Actual / 3560-10 Balance Sheet receive date (when complete report **received)**, figures entered MFIS
- ❑ 3560-7 Actual / 3560-10 Bal Sheet **Initial Review** date (analysis must be complete, additional info needed) –
- ❑ 3560-7 Actual / 3560-10 Bal Sheet **Final Review** date (analysis must be complete & acceptable to the Agency)
- ❑ Audit **received** date entered in MFIS (if applicable)
- ❑ Audit **reviewed** date entered in MFIS (if applicable)
- ❑ Real Estate Taxes

Letter to Borrower:

- ❑ Letter to borrower that actuals have been reviewed & any findings or concerns noted during review

MISC:

- ❑ Questions on Year End Financial review: _____ _____ _____

Date Sent _____Due Back (30 days)_____ Date Received Back_____

PROJECT FINANCIAL AUDIT
Over $500,000 Federal Financial Assistance

An audit should consist of the following items at a minimum:

- ❑ Independent Auditor's Report
- ❑ Financial Statements
  - ○ Balance Sheets
  - ○ Statements of Operations
  - ○ Statements of Changes in Partner's Equity (Deficit)
  - ○ Statements of Cash Flows
- ❑ Notes to the Financial Statements
- ❑ Supplemental Information
  - Management Fee Calculation
  - Insurance Disclosure
  - Return to Owner
  - Changes in Rental Property
  - Accrual to cash schedule
  - Multiple Family Housing Borrower Balance Sheet – form RD 3560-10
  - Multiple Family Housing Project Budget – Form RD 3560-7
  - Supporting Documentation to Form 3560-10 and 3560-7
- ❑ Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
- ❑ Independent Auditor's Report on compliance for Each Major RD Program and Internal control over Compliance required by the Audit guide for Audits of RD Programs
- ❑ Schedule of Findings and Questioned Costs (current year and prior year)
- ❑ Corrective Action Plan (if applicable)

☐ This borrower has $500,000 or less of Federal financial assistance. Audit is not required

☐ No project audits are available completed by anyone else.

COMMENTS:
_____
_____
_____
_____
_____

Agency Review of Annual Financial Reports

_____

Review Completed By Date

_____

PROJECT FINANCIAL AUDIT
Over $750,000 Federal Financial Assistance

A Single audit should consist of the following items at a minimum:

- ❑ Financial Statement(s) 2 CFR 200.510(a)
- ❑ Opinion on Financial Statements 2 CFR 200.515(a)
- ❑ Uniform Guidance Report on Internal Control 2 CFR 200.515(b) (major programs)
- ❑ Uniform Guidance Report on Compliance 2 CFR 200.515(c) (major programs)
- ❑ GAS Report on Internal Control 2 CFR 200.515(b)
- ❑ Schedule of expenditures of Federal Awards 2 CFR 200.510(b) (Example provided)
- ❑ Opinion or Disclaimer of Opinion on Schedule of Federal Awards 2 CFR 200.515(a)
- ❑ GAS Report on Compliance 2 CFR 200.515(c)
- ❑ Schedule of Findings and Questioned Costs 2 CFR 200.515(d) (Example provided)
- ❑ Summary Schedule of Prior Audit Findings 2 CFR 200.511(b)
- ❑ Corrective Action Plan (if findings) 2 CFR 200.511(c) (Example provided)

☐ This borrower has $750,000 or less of Federal financial assistance.
A single audit is not required.

☐ No project audits have been completed by anyone else.

COMMENTS:
_____
_____
_____
_____
_____

Agency Review of Annual Financial Reports

_____

Review Completed By Date

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CHAPTER 5: PROJECT PHYSICAL CONDITIONS

5.1 INTRODUCTION

The existing portfolio of multi-family housing projects constitutes a major asset of the Government and the Agency, but the value of this asset depends upon the quality of its upkeep. This chapter describes the responsibilities of borrowers to maintain the physical condition of the project and of the Agency to exercise appropriate oversight of these responsibilities. The chapter describes the components of adequate physical maintenance, the role of the management plan, and the performance of a physical inspection of the project.

SECTION 1: PROJECT MAINTENANCE *[7 CFR 3560. 103]*

5.2 PURPOSE

The Agency has issued performance standards that describe the physical condition of a properly managed project. The Agency's interest in protecting the physical condition of projects that it has financed includes:

- Providing decent, safe, and sanitary affordable housing to the occupants;
- Protecting and enhancing the security of its investment; and
- Assuring compliance with all applicable State and local laws.

5.3 MAINTENANCE REQUIREMENTS AND STANDARDS OF PHYSICAL CONDITIONS

A. Standards of Physical Conditions

Borrowers are responsible for the long-term, cost-effective preservation of the housing project. The Agency has specified two types of requirements borrowers must meet:

- Performance standards for the project; and
- Procedures and systems that property managers must design and follow.

B. Performance Standards

The regulations in 7 CFR 3560.103(a)(3) specify the performance standards for meeting acceptable physical conditions. The performance standards describe the characteristics the Agency expects to see in a particular component or system, for example:

> "The housing project must have a foundation that is free of evidence of structural failure, such as uneven settlement indicated by horizontal cracks or severe bowing of the foundation wall. Structural members must not have evidence of rot or insect or rodent infestation.
>
> The housing project must have a roof that is free of leaks, defective covering, curled or missing shingles and which is not sagging or buckling."

The performance standards have been incorporated into a physical inspection form to be completed by Agency staff during a site visit. They also have been incorporated into the certifications that accompany the management agreement for the project.

The standards include the following major categories:

- Standards that apply to the site on which the project is located;
- Standards that apply to the exterior maintenance of the building and of the common areas;
- Standards that apply to the interior of the building or buildings; and
- Standards that apply to common areas, such as hallways or elevators.

C. Maintenance Systems and Procedures

Effective maintenance is partly the result of regular routines and partly the result of promptly fixing small problems before they become major ones. Proper maintenance has a direct effect on the tenants' perception of the quality of the housing project. Therefore, the Agency requires borrowers to institute a number of systems and procedures that the borrower must describe in the project's management plan. The requirements for a management plan are described in Chapter 3.

Several systems are part of a sound management program:

- **Preventive maintenance.** Most maintenance work can be predicted and scheduled—this is typically described as preventive maintenance. The Agency requires managers to spell out procedures for scheduling routine tasks, such as garbage and trash removal, snow and ice removal, grounds upkeep, routine painting, and minor repairs. Procedures are also required for the routine maintenance of equipment consistent with service information provided by the manufacturer—biweekly or monthly routine oiling, adjusting, replacement of filters, safety checks of alarms, and outside lighting, etc.
- **Response to calls.** Good upkeep requires a speedy response to complaints or unforeseen problems. The Agency requires managers to establish a system for responding to tenant complaints or to unexpected malfunctions or damage, such as leaks, broken windows, etc.

- **Work orders.** Managers must know what has happened from the time a complaint has been received or a problem has been noted, to an inspection confirming the condition has been corrected. The Agency requires the project to have a work-order system that tracks the date a complaint is received, the inspection to verify the complaint, a report describing the required repair or corrective action, the assignment of the repair, the completion report, and final inspection noting satisfactory completion of the work.

- **Inspections.** Frequent, regular inspections are a major component of an effective maintenance system. The Agency requires management, at a minimum, to perform an annual inspection of each occupied unit and to inspect each unit at move-in and move-out. Inspecting a unit with the tenant at move-in and move-out establishes the condition of the unit at the time the tenant takes possession, and may help clarify responsibility for any damages that have occurred in the unit during the occupancy period.

- **Energy conservation.** Energy conservation efforts are an ongoing responsibility of project management. The Agency requires managers to establish effective systems to reduce energy consumption. These may include energy audits to determine cost-effective techniques of energy conservation, energy-efficient lighting, water-saving fixtures, low-flow toilets, energy-efficient appliances, insulation, caulking and weather-stripping, storm doors and windows, and regular cleaning and replacement of filters and other equipment.

- **Tenant damages.** The Agency requires management to establish a policy and implement a system to obtain reimbursement for damage caused by the tenant to the property beyond normal wear and tear. The policy is to be stated in the tenant's lease as described in Chapter 6 of this Handbook.

- **Accessibility issues**. The Agency requires the borrower and/or management to establish a policy regarding project and unit accessibility for applicants, tenants, and employees in accordance with applicable civil rights legislation.

  ◊ In projects that were ready for occupancy <u>on or before January 26, 1993</u>, when public areas are altered, they must be altered to Americans with Disabilities Act Accessibility Guidelines (ADA/AG) standards. (Public areas are those areas used by individuals other than tenants and their guests. This includes offices used to pay bills or to inquire about service or employment, public restrooms, and buildings used for voting or public meetings.)

  ◊ In projects that were ready for occupancy <u>after January 26, 1993</u>, public areas must be designed and constructed to ADA/AG standards.

  ◊ In accordance with the Fair Housing Act, in Multi-Family Housing projects that were ready for occupancy <u>on or before March 31, 1991</u>, FHA/AG architectural requirements do not apply, even during project rehabilitation.

◊ In Accordance with the Fair Housing Act, in multi-family housing projects that were ready for occupancy after March 11, 1991:

- ♦ All ground floor units in buildings with four or more dwelling units must be designed and constructed in a manner that is adaptable to individuals with disabilities.
- ♦ All units must be adaptable if there is an elevator.
- ♦ Covered Multi-Family Housing projects must have:
  - ✓ An accessible entrance on an accessible route;
  - ✓ Accessible public and common-use areas;
  - ✓ Usable doors;
  - ✓ Accessible routes into and through the dwelling unit;
  - ✓ Accessible light switches, electrical outlets, and environmental controls;
  - ✓ Reinforced bathroom walls; and
  - ✓ Usable kitchens and bathrooms.

Projects that were constructed (or which had substantial alterations) after June 11, 1982 must be constructed in accordance with the UFAS standards.

- 5 percent of the units or one unit whichever is greater must be fully accessible
- The mix of units are to be comparable to the variety of other project (i.e., 1,2,3 bedrooms
- All common area must be accessible per UFAS

The electronic Multi-Family Housing Project Management and Occupancy Review Form available in Multi-Family Information System (MFIS) includes space for the Loan Servicer to comment on the adequacy of the maintenance systems adopted by project management.

D. Requirements for Labor Housing

There are no separate performance standards for year-round labor housing and rental or cooperative housing. Seasonal labor housing must meet conventional performance standards and must have insulation as necessary to protect the facility during the off-season period.

5.4 CORRECTING DEFICIENCIES

There are a number of ways in which the need for maintenance is identified:

- Management staff may uncover, anticipate, or expect such maintenance;
- Tenants may make complaints; and
- Agency staff may identify defects in the course of a site visit.

No matter how the problem was identified, the borrower is responsible for correcting it.

The borrower is responsible for adequate maintenance and upkeep of the project that complies with Agency performance standards. The Agency understands, however, that property maintenance is an ongoing process and that there may be instances when diligent borrowers are temporarily unable to achieve 100 percent compliance with Agency standards. In such instances, the Agency will not penalize borrowers—as long as it is evident that the borrower is actively striving to return to full compliance, as soon as possible (see the standards listed in 7 CFR 3560.103).

This flexibility is <u>not</u> extended to projects where the deficiencies are so extensive that the property would be declared in substantial noncompliance. In these instances, the projects' viability is called into question, as well as the effectiveness of the management's maintenance program. The Agency should coordinate with and or report to State and local inspection authorities, where applicable, when health and safety issues exist at a property.

The borrower shall immediately inform the Agency of any deficiency for which correction requires repairs that cannot be paid out of project operating funds and immediately initiate procedures to access project reserves (see Chapter 4 of this Handbook). The Agency will in turn provide the borrower with a timeframe for completing the repairs. If the borrower cannot meet the Agency required timeframe, then they must provide documentation and justification why they cannot meet such a timeframe.

5.5 PAYING FOR MAINTENANCE EXPENSES

MAINTENANCE IS PAID FOR IN TWO WAYS:

- Routine physical maintenance, such as repainting an empty unit, replacing a broken window, snow removal or grounds upkeep, is part of the operating budget and paid for out of annual operating income.

- Major capital expenditures are paid for by withdrawals from the reserve account. Capital expenditures are addressed as long-term improvements on the front of the operating budget.

Rule-of-Thumb

A capital expenditure is typically defined as an expenditure on an item for which the useful life is greater than one year. For example:

- Repaving the parking lot is a capital cost; fixing a pothole is an operating cost.
- Repainting the exterior of the entire project is a capital expenditure; repainting units on a routine basis is considered routine maintenance.

Chapter 4 of this Handbook describes the process for accessing the reserve account to pay for major capital improvements.

SECTION 2: CAPITAL PLANNING

5.6 OVERVIEW

This section describes how borrowers, with assistance from Agency staff, can plan for major capital expenses and how to pay for them. This type of planning can take many forms. The two most common forms used by the Agency are an annual capital expenditure budget and a capital needs assessment. Refer to Chapter 4 of this Handbook for preparation of an annual capital expenditure budget.

5.7 CAPITAL NEEDS ASSESSMENT

A. Overview

A capital needs assessment (CNA) identifies the immediate and future capital needs of a project. It is based on a physical inspection and a life-cycle analysis of a project's major building components systems, equipment, and exterior amenities, such as the site lighting and parking lots. The CNA includes a replacement schedule that anticipates the useful life of each item, and estimates when they will need to be replaced and the cost. Preparation of a CNA is an eligible project expense.

B. General Criteria:

- A capital needs assessment should be prepared at a reasonable cost by an individual or firm with professional experience in multi-family housing design, construction, cost estimating or similar qualification.

- The CNA should be prepared in accordance with generally accepted industry practices.

- The assessment should include the detailed items listed on the *Form RD 3560-11* Multi-family Housing Physical Inspection Report. The assessment time period should be between 10 and 20 years.

- The estimated repair and replacement costs and estimated useful life spans for the components should be based on data from a nationally recognized source, such as RS Means "Repair and Remodeling Cost Data" and Marshall and Swift "Residential Cost Handbook".

C. Determining a Project's Capital Needs

The amount required for deposit into the replacement reserve account is established for new projects during the loan origination phase, based in part on a life-cycle cost analysis of selected materials going into the project (see 7 CFR 3560.65). For information on conducting life-cycle analyses, refer to Chapter 3 of HB-1-3560.

For existing projects, the Agency may require the development of a capital needs assessment in the following circumstances:

- When ownership of the project is transferred;
- When the loan is reamortized;
- When there is a writedown of the project loan; or
- At the borrower's request.

D. Agency Review

Capital needs assessments and a proposed, updated annual operating budget, including a revised capital plan and any proposed increase in contributions to replacement reserves and project rents, are submitted to the Field Office for Agency review. Loan Servicing Staff should review the requests based on Agency guidance and the budget review procedures in Chapter 4.

SECTION 3: AGENCY OVERSIGHT OF BORROWER PERFORMANCE

5.8 OVERSIGHT DURING DESIGN AND CONSTRUCTION

Agency oversight of the borrower's capacity to maintain the physical project in compliance with its standards and requirements begins during the loan origination phase. As part of its design review, the Agency examines plans and working drawings to see whether the project has been designed for easy maintenance and long-term durability.

Borrowers must describe the systems and procedures that will be used to maintain the project during the occupancy period in the management plan. Agency staff reviews the proposed management plan for compliance in accordance with procedures described in Chapter 3. Agency staff should analyze the description of the maintenance systems in the management plan, noting any points that appear unrealistic, incomplete, or incorrect.

CHAPTER 6: PROJECT OCCUPANCY

6.1 INTRODUCTION

The purpose of this chapter is to present the occupancy rules for multi-family housing projects and the Agency's procedures for determining borrower compliance. Agency procedures for ensuring borrower compliance are summarized at the end of the chapter.

SECTION 1: TENANT ELIGIBILITY REQUIREMENTS *[7 CFR 3560.152]*

6.2 GENERAL ELIGIBILITY—INCOME ELIGIBILITY

To be admitted to multi-family housing, applicants must meet basic requirements.

- Have income that does not exceed the limits defined by the Agency;
- Meet the program definition of an eligible household.

A borrower may determine an applicant ineligible for occupancy based on screening criteria other than those required by the Agency only if such criteria are included in the project's management plan. The screening criteria may not contain arbitrary or discriminatory rejection criteria, but may consider an applicant's past rental and credit history and relations with other tenants.

6.3 INCOME REQUIREMENTS

Three different income limits are used to establish eligibility for Multi-Family Housing programs. The National Office determines the income limits and updates the limits whenever they are revised. Adjusted income should be compared with the below-listed income limits to determine the category in which each household falls:

- The very low-income limit is established at approximately 50 percent of the median income for the area, adjusted for household size;
- The low-income limit is established at approximately 80 percent of the median income for the area, adjusted for household size; and
- The moderate-income limit is established by adding $5,500 to the low-income limit for each household size.

The borrower has the right to determine a minimum income level for households of various sizes for applicants who will not be receiving rental assistance. These guidelines must be administered consistently for all potential applicants.

6.4 RESERVED

6.5 DETERMINING AN ELIGIBLE HOUSEHOLD

Although it may seem obvious, deciding who is a part of an applicant's household is an important, but not always simple, task. The word "household" applies to individuals and family members who intend to live in a unit.

A. Defining a Household

Deciding who can be considered a household member affects many decisions the borrower must make, including:

- The number of bedrooms the family needs;
- The members' income that must be counted and the income limits that should be used;
- The extent to which the family qualifies for certain income deductions and certain preferences; and
- The household member who can sign legal documents.

B. Who Can Be Counted as a Household Member?

A household may be made up of a variety of members and may have a specific definition. The following are examples of members and types:

- **Elderly families:** A household where the tenant, co-tenant, member, or co-member is at least 62 years old, or disabled, as defined below. An elderly family may include a person younger than 62 years of age. (To receive an elderly family deduction, the person who is elderly, disabled must be the tenant, cotenant, member, or co-member.)
- **Individual with Disabilities:** The term disability is considered equivalent to the term handicap. Eligibility requirements for fully accessible units are contained in 7 CFR 3560.154(g)(1)(i) and 3560.155(b). A person is considered to have a disability if either of the following two situations occur:

(1) <u>As defined in section 501(b) of the Housing Act of 1949</u>. The person is the head of household (or his or her spouse) and is determined to have an impairment which:

(i) Is expected to be of long-continued and indefinite duration;

(ii) Substantially impedes his or her ability to live independently; and

(iii) Is of such a nature that such ability could be improved by more suitable housing conditions, or if such person has a developmental disability as defined in section 102(7) of the Developmental Disability and Bill of Rights Act (42 U.S.C. 6001(7)).

(2) <u>As defined in the Fair Housing Act; the Americans with Disabilities Act; and section 504 of the Rehabilitation Act of 1973</u>. The person has a physical or mental impairment which substantially limits one or more of such person's major life

activities; a record of such impairment; or being regarded as having such an impairment. The term does not include current, illegal use of or addiction to a controlled substance. As used in this definition, physical or mental impairment includes:

(i) Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genito-urinary; hemic and lymphatic; skin; and endocrine;

(ii) Any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term "physical or mental impairment" includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech and hearing impairments, cerebral palsy, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, Human Immunodeficiency Virus infection, mental retardation, emotional illness, drug addiction (other than addiction caused by current, illegal use of a controlled substance), and alcoholism;

(iii) Major life activities means functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working;

(iv) Has a record of such an impairment means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities;

(v) Is regarded as having an impairment means:

(A) Has a physical or mental impairment that does not substantially limit one or more major life activities but that is treated by the borrower or management agent as constituting such a limitation;

(B) Has a physical or mental impairment that substantially limits one or more major life activities only as a result of the attitudes of others toward such impairment; or

(C) Has none of the impairments described in this definition but is treated by another person as having such an impairment.

- **Household.** One or more persons who maintain or will maintain residency in one rental or cooperative unit, but not including a resident assistant or chore service worker.

- **Resident assistant.** A person residing in a tenant’s housing unit who is essential to the well-being and care of the persons who are elderly or have handicaps or disabilities residing in the unit, but is not obligated for the person’s financial support

and would not be living in the unit except to provide the needed support services. While the resident assistant may be a family member, the resident assistant may not be a dependent of the household for tax purposes and is not subject to the eligibility requirements of a tenant or member. A resident assistant is not a chore service worker. A resident assistant may function in any type of housing affected by this section.

- **Foster children.** Eligible families may include foster children, as long as the children do not cause overcrowding. However, foster children are not considered family members for the purposes of determining income or deductions from income, or to determine household size to compare with income limits.

- **Remaining family members.** Remaining members of resident families are family members who stay in a unit after other members of the household leave. These members will be reevaluated for eligibility in accordance with Section 7 of this chapter. Agency regulations may require remaining tenants to move to a unit of appropriate size or exit the project.

- **Students.** A student or other seemingly temporary resident of the community who may be considered an eligible tenant when all of the following conditions are met:

  ◊ The student is of legal age in accordance with the applicable state law or is otherwise legally able to enter into a binding contract under state law;

  ◊ The person seeking occupancy has established a household separate and distinct from the person's parents or legal guardians;

  ◊ The person seeking occupancy is no longer claimed as a dependent by the person's parents or legal guardians pursuant to Internal Revenue Service regulations, and evidence is provided to this effect; and

  ◊ The person seeking occupancy signs a written statement indicating whether or not the person's parents, legal guardians, or others provide any financial assistance and this financial assistance is considered as part of current annual income and is verified in writing by the borrower.

6.6 ADDITIONAL REQUIREMENTS FOR ELDERLY UNITS, CONGREGATE HOUSING, AND GROUP HOMES

In addition to the requirements listed in Paragraph 6.2, applicants for elderly units, congregate housing, or group homes must meet the additional requirements described below.

A. Elderly Units and Congregate Housing

To be admitted to elderly units or congregate housing:

- Applicants and tenants must qualify as an elderly or disabled.

- Nonelderly persons are eligible for occupancy as long as they are members of an elderly household and live in the same unit.

- Priority can be given to tenants who agree to participate in the services provided by the facility.

B. Group Homes

To be admitted to a group home:

- Applicants/tenants must be in need of the special services provided by the group home.

- Applicants must demonstrate a need for such housing and cannot be required to be a part of an ongoing training or rehabilitation program.

- Applicants must be selected from the market area prior to considering applicants from other areas.

A group home may limit occupancy to a specific group of tenants (e.g., eligible elderly tenants, developmentally disabled or mentally impaired tenants) if it is outlined in the borrower's management plan.

6.7 INELIGIBLE TENANT WAIVERS

The Agency may authorize the borrower in writing, upon receiving the borrower's written request with the necessary documentation, to rent vacant units to ineligible persons for temporary periods to protect the financial interest of the Government. Likewise, this provision may extend to a cooperative. This authority will be for the entire project for periods not to exceed one year. Within the period of the lease, the tenant may not be required to move to allow an eligible applicant to obtain occupancy, should one become available. The Agency must make the following determinations. Age restrictions may not be waived.

- There are no eligible persons on a waiting list.

- The borrower provided documentation that a diligent but unsuccessful effort to rent any vacant units to an eligible tenant household has been made. Such documentation may consist of advertisements in appropriate publications, in several public places, and in other places where persons seeking rental housing would likely make contact; holding open houses; and making appropriate contacts with public housing agencies and organizations, Chambers of Commerce, and real estate agencies.

- The borrower agrees to publish a notice in the local newspaper to inform the public of the borrower's intent to temporarily rent apartments to all persons without regard to income restrictions.

- The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure and the Agency's approval of the waiver will be for a limited duration.

- That the lease agreement will not be more than 12 months and at its expiration will convert to a month-to-month lease. The monthly lease will require that the unit be vacated upon 30 days' notice when an eligible applicant is available.

- Tenants residing in Rural Rental Housing (RRH) units who are ineligible because their adjusted annual income exceeds the maximum for the RRH projects will be charged the RHS approved note rate rental rate for the size of unit occupied in a Plan II RRH project. In projects operated under Plan I, ineligible tenants will be charged rental surcharge of 25 percent of the approved note rate rental rate. Plan I and Plan II projects are defined in 7 CFR 3560.11.

SECTION 2: CALCULATING INCOME AND INITIAL CERTIFICATION

6.8 BORROWER AND APPLICANT/TENANT RESPONSIBILITY

Borrowers of all Rural Rental Housing properties must verify and document in the tenant's file all income, assets, expenses, deductions, family characteristics, and any other factors that affect family eligibility or level of assistance. This requirement excludes those residents of On Farm Labor Housing who are living in housing provided on a non-rental basis. With USDA guidance the borrower should develop verification and documentation procedures for the properties they manage and ensure that on-site property staff responsible for these functions are trained to understand and properly implement these procedures. Effective and efficient borrower, agent, and property staff performance in this area is fundamental to obtaining the correct information needed for accurate rent determinations and assistance payments. The following are essential procedures to reduce the incidence of improper reporting.

- Applicants/tenants and their adult family members must sign consent forms to authorize the borrower to collect information to verify eligibility, income, assets, expenses, and deductions. Applicants and tenants who do not sign required consent forms will not receive assistance.

- Family members 6 years of age and older must provide the borrower with a complete and accurate social security number. For any members of the family who do not have a social security number, the applicant or family member must certify that the individual has never received a social security number.

- Information received via third party verification should be reviewed and interpreted, and allowable deductions applied to determine the income used to calculate rent and rental assistance.

- The borrower must develop tracking and monitoring procedures to ensure that the required re-certifications are initiated and completed on time.

- The borrower must handle any information obtained to verify eligibility or income in accordance with the Privacy Act.

6.9 CALCULATION OF TENANT INCOME

Borrowers use tenant income information to: (1) help determine whether an applicant is eligible to reside in multi-family housing; (2) calculate the applicant's ability to pay rent; and (3) determine the amount of rental assistance the household is eligible to receive. This section provides guidance for calculating and verifying income for each of these purposes.

A. Key Concepts for Income Determinations

1. Income Definitions

Two income definitions are used: annual income and adjusted income. Whenever income determinations are made, it is essential that borrowers use the correct income definition and consider income from the appropriate household members.

- **Annual income.** Annual income is used as the base for computing adjusted income. Income of all household members should be considered when computing annual income. **Attachment 6-A**, Annual Income Inclusions and Exclusions can be used to determine which sources of income to count and which to exclude. *Form RD 3560-8, Tenant Certification* illustrates the calculation of annual income. Paragraph 6.8 B in this section provides additional information on calculating annual income.

- **Adjusted income.** Adjusted income is used to determine whether an applicant is income eligible to reside in multi-family rental housing or to receive rental subsidies. For guidance on calculating adjusted income, see Paragraph 6.8 C in this section.

2. Projecting Income for a 12-Month Period

Current income and family circumstances may be used to estimate the household's income over the next 12 months, unless there is verifiable evidence of a likely change in circumstances. Historical information may be used to estimate income that is anticipated to be received for less than 12 months. For example, if one of the household members is a seasonal worker, the income attributable to that worker should be based upon past history, rather than annualizing current income.

Example—Annualizing Short-Term Income

Assume a family member who currently has no income historically has seasonal income during the summer months and earns on an average of $4,000 during that time. Confirm with the applicant that the same seasonal pattern is expected and use historical data to project income for the coming 12 months.

3. Income of Temporarily Absent Household Members

Members may be temporarily absent from the household for a variety of reasons, such as temporary military duty activation, temporary employment, or students who live away from home during the school year. The income of these household members is considered when computing annual income. Households with a member permanently confined to a hospital or nursing home may choose to either include annual income attributable to such person, less deductions for which the person would qualify, <u>or</u> exclude the annual income attributable to such person and not take any deductions for which the person would qualify.

Example—Temporarily Absent Member

James Brown and his wife have applied for a unit. At the moment, James is working on a construction job on the other side of the state and comes home every other weekend. He earns $600 per week and uses approximately one-third of that amount for temporary living expenses. The full amount of the income earned would be counted for both repayment and annual income.

4. *Zero Income.*

It is the policy of Rural Development not to accept a tenant certification for an applicant or tenant with zero income unless all income is specifically exempted. If the tenant or applicant experiences regular lay-off, as part of his or her employment, the tenant or applicant will not be certified as a zero income tenant. The tenant will be certified based on their annual income. Third party verifications must be obtained from the employer. If the tenant or applicant typically receives unemployment during periods of layoff, the unemployment income is included in the income calculation. The tenant will not be re-certified when laid off unless the layoff is inconsistent the employment or income history of the tenant.

In cases where an applicant or tenant is claiming they have no household income, nor can the tenant or applicant anticipate a source of income, it will be necessary for the applicant or tenant to demonstrate financial capability to meet other basic living expenses and the rental charge. This amount must include income for essential living expenses such as, food, clothing, diapers, transportation and any nonessentials items being paid such as telephone, cable television, internet service etc. The basis for this income must be documented in the file. Guidance for the verification of zero income is found in Attachment 6-B.

The borrower must review the circumstances of the tenant quarterly to ascertain if circumstances have changed. The borrower must remind the tenant that the lease specifically states that it is the tenant's responsibility to immediately report changes in income to management.

B. Calculating Annual Income

Attachment 6-A, Annul Income Inclusions and Exclusions provides a list of possible income and indicates whether the source is counted or excluded from annual income.

C. Calculating Adjusted Income

Adjusted income is used to determine eligibility for Multi-Family Housing programs, as well as eligibility for and the amount of payment subsidies under rental assistance.

Adjusted income is calculated by subtracting from annual income any of five deductions that apply to the household. Not all households are eligible for all deductions. Exhibit 6-1 summarizes these deductions. Attachment 6-C, Allowable Deductions, provides detail concerning allowable deductions. The remainder of this paragraph provides guidance on determining whether a family is eligible for each deduction and verifying and calculating these amounts.

Exhibit 6-1 **Allowable Deductions from Annual Income**		
	Elderly	**Nonelderly**

Deduction	Households	Households
Dependent deduction	Yes	Yes
Child care expenses	Yes	Yes
Elderly household	Yes	No
Disability assistance	Yes	Yes
Medical expenses	Yes	No

1. Dependent Deduction

A deduction from annual income of $480 is made for each household member who qualifies as a dependent. Dependents are household members who are not the head or spouse and who are age 17 or younger, an individual with a disability, or a full-time student. If an applicant requests a deduction for dependents attending school full time, the applicant must provide documentation from the school that the dependent is enrolled as a full-time student.

2. Child Care Expenses

Reasonable unreimbursed child care expenses for the care of children under the age of 13 are deducted from annual income if: (1) the care enables a household member to work or go to school; (2) no other adult household member is available to care for the children; and (3) in the case of child care that enables a household member to work, the expenses deducted do not exceed the income generated by that household member. If the child care provider is a household member, the cost of the children's care cannot be deducted.

Verification of Child Care Expenses

Child care hours must parallel the hours the household member works or goes to school. An acceptable format for verifying child care expenses is a letter on the child care provider's letterhead or a copy of a signed child care contract.

To qualify for the deduction, the applicant must:

- Identify the children who are receiving the child care and the household member who can work or go to school as a result of the care;
- Demonstrate that there is no adult household member available or able to care for the children;
- Identify the child care provider, the hours of child care provided, and the costs; and
- If the expenses enable a household member to go to school, identify the educational institution. The household member need not be a full-time student.

3. Elderly Household Deduction

A single $400 deduction is made from annual income for any elderly household. To be considered an elderly household, the head of household, spouse, or sole member of a

household who is party to the lease must be 62 years of age or older, or an individual with a disability.

In the case of a family where the deceased tenant or spouse was at least 62 years old or an individual with disabilities, the surviving household members may continue to reside in a housing project after the departure or death of the tenant or co-tenant, provided that:

- They are eligible with respect to adjusted income;
- The surviving household members occupied the dwelling with the deceased member at the time of death;
- They execute a tenant certification form establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Nonelderly or nondisabled surviving members of an elderly or disabled household are not entitled to the elderly family adjustment to income.

4. Deductions for Disability Expenses

Reasonable expenses for the care of an individual with disabilities in excess of three percent of annual income may be deducted from annual income if the expenses:

- Enable the individual with disabilities or another household member to work;
- Are not reimbursable from insurance or any other source; and
- Do not exceed the amount of income earned by the person who is able to work as a result of the expenses.

Typical Disability Assistance Expenses

- Care attendant to assist an individual with disabilities with activities of daily living directly related to permitting the individual or another household member to work.
- Special apparatus, such as wheelchairs, ramps, and adaptations to vehicles or workplace equipment, if directly related to permitting the individual with disabilities or another household member to work.

Along with other forms of documentation, to qualify for this deduction applicants must identify the individual with a disability on the application.

5. Deduction for Medical Expenses (for elderly households only)

Medical expenses may be deducted from annual income for elderly households if the expenses (1) will not be reimbursed by insurance or another source; and (2) when combined with any disability assistance expenses are in excess of three percent of annual income. **See Attachment 6-C** for eligible deductions

Typical Medical Expenses

- Services of physicians other healthcare providers;
- Services of hospitals other healthcare facilities;
- Medical premiums;
- Prescription and nonprescription medicine;
- Dental expenses;
- Eyeglasses and eye examinations;
- Medical or health products or apparatus (hearing aids, wheel chairs, etc.);
- Live-in or periodic medical care (e.g., visiting nurses or care attendants);
- Bandages, syringes, continence shields, and other nonprescription items recommended by a physician; and
- Periodic payments on accumulated medical bills.

If the household qualifies for the medical expenses deduction, expenses of all members are considered. For example, if a household included the head (grandmother, age 64), her son (age 37), and her granddaughter (age 6), the medical expenses of all three household members would be considered.

One of the most challenging aspects of determining allowable medical expenses is estimating a household's medical expenses for the coming year. While some anticipated expenses can be documented easily (for example, Medicare or other health insurance premiums and ongoing prescriptions), others need to be estimated. The borrower should use historical information about medical bills to estimate future expenses. However, the estimates should be realistic. For example, if the household has a significant medical bill, the borrower would count only that portion of the bill that is likely to be paid during the coming year.

Example – Calculating the Medical Expense Deduction

The Jensons are an elderly household with annual income of $25,000 and anticipated medical expenses of $3,000 that are not covered by insurance or another source. The allowable medical expenses would be:

Total medical expenses	$3,000
(*less*) 3% annual income ($25,000 x 0.03)	-$ 750
Allowable medical expenses	$2,250

6.10 EVALUATING APPLICANTS' ASSETS

Assets can affect an applicant's ability to be qualified as an eligible tenant. Many types of assets generate income that must be included in the calculations of annual income. **Attachment 6-D**, Net Family Assets presents a list of assets that must be considered when making these determinations and also identifies certain types of assets that are not considered.

A. Reporting Assets

Applicants must provide information about household assets at the time of application and whenever an income is reverified. Applicants must provide sufficient information to enable the borrower to verify the asset information and compute the market and cash value of the asset.

B. Calculating Market and Cash Value

The market value of an asset is simply its dollar value on the open market. For example, the market value of $2,000 in a savings account is $2,000 and the market value of real estate is its appraised value. The cash value of an asset is the market value, less reasonable expenses to convert the asset to cash. For example, the cash value of stock worth $5,000 would be $5,000 less any broker's fee.

Example—Calculating Cash Value of an Asset

Mr. Smith has $10,000 in an IRA account. The account's market value is $10,000. To withdraw funds from the account, Mr. Smith must both pay a withdrawal penalty and taxes on the amount withdrawn.

The cash value of the IRA account is:

Market value		$10,000
Withdrawal penalty	*less*	200
Tax	*less*	2,000
Cash Value		$7,800

C. Retirement Assets

Retirement assets are savings and investments that have been specifically designated as retirement funds. Not all retirement assets are considered. If the applicant can receive the retirement funds only by borrowing them, or upon retirement or termination of employment, the funds are not counted as assets for determining income. If the applicant can withdraw retirement funds without retiring or terminating employment, the funds are counted as assets, even though penalties may apply.

D. Calculating Income from Assets

For the purpose of computing annual income, the assets of all household members are considered. In addition, if any household member has disposed of assets for less than fair market value during the two years preceding the effective date of certification or recertification, the asset must be considered when calculating income from assets for annual income.

1. Two Methods for Calculating Income from Assets

Two different methods of calculating income from assets are used, depending upon the total cash value of household assets:

If the cash value of total assets is $5,000 or less, the amount of asset income included in annual income is the actual income to be derived from these assets.

If the cash value of total assets is more than $5,000, the amount of asset income included in annual income is the greater of (1) the actual income to be derived from the assets; or (2) an imputed income from assets that is calculated by multiplying the total cash value of assets by the current HUD passbook rate, which can be found in the HUD 4350.3 Occupancy Handbook, Chapter 5, available at http://www.hudclips.org. Generally, the imputed income from assets is larger than the actual income to be derived from the assets when an applicant owns non-income-producing assets of significant value.

Example—Income from Assets for Annual Income Calculation

Charles and Patty Brown, both age 40, have applied for a Section 515 unit. The Brown family has the following assets.

A certificate of deposit of $6,500 they have been saving for a down payment. It earned 6.8 percent or $442 of interest last year.

A savings account of $4,000 earning four percent interest annually.

The six-month average balance in the checking account is $300 (non interest-bearing account).

The cash value of the Browns' assets is $10,800 ($6,500 + $4,000 + $300). The assets are more than $5,000. To compute income from assets, use the greater of actual income or imputed income.

	Cash Value	**Actual Income Earned**	**Imputed Income**
Checking Account 6 mo average balance	$300	$0	**$216 ($10,800 x 0.02)**
Certificate of Deposit	$6,500	$442 ($6,500 x 0.068)	
Savings	$4,000	$160 ($4,000x 0.04)	
Total	**$10,800**	**$602**	

2. Assets Disposed of for Less than Fair Market Value

Applicants who dispose of assets for less than fair market value have, in essence, voluntarily reduced their ability to afford housing. Therefore, assets disposed of for less than fair market value during the two years preceding a determination of annual income must be used in the annual income calculation. Assets disposed of for less than fair market value as a result of foreclosure, bankruptcy, divorce, or separation are not included in this calculation.

The amount of income to be included in annual income is the difference between the market value of the asset and the amount that was actually received (if any) in the disposition of the asset.

Example—Valuing a Disposed Asset

An applicant sold a property to a relative for $15,000 on July 1, 1996. The property was valued at $30,000 and had no loans against it.

Market value	$30,000
(*Less*) Settlement costs	$2,000
(*Less*) Sales price	$15,000
Cash value	$13,000

The $13,000 would be counted as an asset for any annual income determination conducted until July 1, 1998. Even though there would be no actual income from this asset, the $13,000 would be used to establish total assets to determine the amount to be counted as annual income.

6.11 VERIFICATION PROCEDURES

Each applicant must provide the income, expense, and household information needed to enable the borrower to make income determinations. Most of this information should be provided on the application, but some additional follow-up with the applicant may be required. The borrower must verify information provided by the applicant prior to admission.

A. Verification Requirements

Verification of employment income, as well as any household income from sources other than employment, must be verified by the borrower prior to submission of *Form RD 3560-8* to the Agency. Each applicant must sign a request for verification of employment at the time of application. Copies of this form must accompany any request for verification from third-party sources. Written verifications provided by third-party sources or documents prepared by third-party sources are generally preferred. Oral verifications, if accepted, must be documented carefully.

Written income-related verifications are valid for 90 days and may be valid for an additional 90 days with oral reverification at the end of the 90-day period. In no case may information that is older than 180 days be used.

When it is not immediately possible to obtain the written verification from the income source, the income may be temporarily verified by actually examining the income checks, check stubs, or other reliable data the person possesses which indicates gross income. Income verification is required for tenants of Off-Farm Labor Housing—domestic

laborers including migrant farmworkers. Income verification is not required for tenants of On-Farm Labor Housing.

Farm labor employment verification is required for all domestic farm laborers, whether they are year-round, seasonal, or migrant farmworkers, or farmworkers living in On-Farm Labor Housing.

Third-party verification of income and employment, as applicable, is required whenever it is possible or available.

When third-party verification of income and employment is not possible or available, the applicant or tenant may provide the borrower with an award and benefit letter, cost of living adjustment notice, benefit statement, bank statement, or actual benefit check. Using this documentation, the borrower may "self-certify" the farmworker's application using any available documents or records the applicant may have or information the applicant can provide. In the absence of available income and employment records, the borrower may forecast income expected to be received by the tenant during occupancy for determining eligibility and rental assistance.

B. Verification Procedure

The borrower must establish a verification procedure to review applicant information. The procedure must ensure accurate determinations of eligibility and respect the confidentiality of all information on applicants and residents. See Attachment 6-I, Eligibility, Income, and Deduction Checklist, for a sample eligibility, income, and deduction checklist.

1. Information to Verify

The borrower must verify the following information:

- **Disability:** Disabilities are verified only if necessary to qualify the household as an elderly family, or if a disability affects the household's eligibility for deductions from income. Verification may be provided by a physician, a clinic, welfare agency, the Social Security Administration, or other knowledgeable service.

- **Household composition:** Verification of household composition can be accomplished through a variety of sources and documents. For example, a birth certificate or custody agreement verifies that a minor child is part of the household. Also, divorce or separation agreements can verify that an individual is no longer a member of the household.

- **Income:** Acceptable Income Verification Sources for verifying income are described below in Exhibit 6-3.

Exhibit 6-3

Acceptable Income Verification Sources

- **Verification of Employment:** After the applicant/tenant submits a form authorizing the borrower to verify employment, the borrower must send this form to each employer for verification of employment of each household member.
- **Zero Income Persons:** For Verification Guidance, see Attachment 6-B.
- **Self-Employed Persons:** Self-employed applicants/ tenants must provide current documentation of income and expenses, which cannot be older than the previous fiscal year. The borrower must compare the income and expenses information provided by the applicant with the latest income tax return and clarify any discrepancies.
- **Unemployment and Unemployment Benefits:** Unemployed applicants/tenant must complete a form, which provides their current employment status and requires them to agree to inform the Borrower immediately, in writing, if their employment status changes. Applicants/tenants receiving unemployment benefits must provide the most recent award or benefit letter prepared and signed by the authorizing agency to verify the unemployment income.
- **Regular, Unearned Income (e.g., Social Security, pensions, workers compensation):** Applicants/tenants must provide a copy of the most recent award or benefit letter prepared and signed by the authorizing agency. Information must be updated every 12 months to account for cost-of-living increases or changes in benefits.
- **Public Assistance:** Applicants/tenants must provide a copy of the most recent award or benefits letter prepared and signed by the authorizing agency to verify the amount of public assistance received.
- **Alimony or Child Support Payments:** The applicant/tenant must provide a copy of the divorce decree, separation agreement, or other document indicating the amount of the required support payments. The applicant/tenant must also report the amount received during the past twelve months. If the applicant/tenant reports that the amount required by the agreement is not being received, the applicant/tenant must document that assistance has been requested from the state or local entity responsible for enforcing payment.
- **Support for Foster Children or Adults:** Payments received for the care of foster children or foster adults may be considered when calculating repayment income. Documentation must be provided indicating the amount of money received for the care of foster children or adults, and the anticipated period of time the support will be provided.
- **Income Tax Return:** For self employment, a complete, legible copy of the most recently filed Federal income tax form may be submitted for each applicant/tenant, unless the person was exempted from filing a return.
- **Verification of Assets and Income from Assets:** The borrower requests that financial institutions verify account balances. For some assets such as mutual funds or 401(k) accounts, copies of year-end statements can provide information about annual income. Applicants/tenants must certify whether any asset has been disposed of for less than fair market value.

2. Release and Consent Form

A form verifying employment (developed by the borrower) gives applicant or resident permission for the borrower to ask questions about and verify information related to the household income and other circumstances that affect eligibility and the amount the household must pay. Applicants must sign the form as a condition of admission and continued occupancy.

The form must be signed by the household head and all other household members whose income, assets, or other circumstances require verification. As long as the

borrower retains the form with original signatures in its file, a photocopy of the authorization may be provided to verification sources.

The borrower must ask applicants/residents to execute the form even in cases where the person has not reported any income.

3. Social Security Numbers

Prospective tenants must provide the borrower with Social Security Numbers for every tenant or co-tenant in the household. The borrower may use Social Security Numbers to verify income information that is provided. Social Security Numbers must be verified only once for each resident.

Documentation of the Social Security Number will be provided with a valid Social Security card or other evidence of the Social Security Number, such as a driver's license. If the documentation is sent by mail, the applicant may submit a photocopy.

If the applicant does not have the documentation, the applicant should submit a signed certification stating his/her Social Security Number. The applicant then has 60 days to submit acceptable documentation of the Social Security Number. This 60-day period can be extended for another 60 days for elderly applicants.

4. Wage Matching Requirement

If permitted by State law, states are required to fully implement and utilize income matching of tenants. See Chapter 9 of the HB-2-3560 for more information.

5. Tenant File Documentation

Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer. See Attachment 6-J, Required Tenant File Documentation, for a list of required documentation that must be retained in each tenant file.

6.12 THE SOLDIERS AND SAILORS' RELIEF CIVIL ACT

Rural Housing Service is required to provide tenants the benefits of the Soldiers and Sailors' Civil Relief Act of 1940, as amended

The Soldiers' and Sailors' Relief Act of 1940 was established to protect those who serve the United States in the Armed Forces. The Act applies to all persons on active duty including reserve component service members called to active duty.

A tenant, co-tenant or spouse may terminate a lease covering premises occupied as a dwelling at any time following the date of the beginning of the period of the military service. The termination will be in writing and delivered to the property manager or the management firm in person or by mail; following the date of the beginning of the military service (a set of appropriate

military orders should accompany the termination letter). However, the lease termination will not be effective until 30 days after the first date on which the next rental payment is due. Example: next rent payment date is March 1; termination will be effective March 30.

Guardians who were not originally listed as tenants, but are so designated by the tenant or co-tenant, will be permitted to reside in the unit to care for minors while the tenant or co-tenant is absent due to military service. The term "guardian" means immediate family member, relative or friend.

The Act does not relieve the recently activated military person or that persons' household from meeting financial obligations. However, the Act does protect the soldier's dependent(s) left behind (occupying family dwellings) from undue eviction or distress.

A. Should eviction be necessary for violation of lease requirements, the Act provides opportunity for a stay of eviction for up to three consecutive months. Under no circumstance are borrowers entitled to take eviction matters into their own hands or to inform tenants that they must move because they no longer can afford the rent. The borrower may give the tenant notice of lease violation and termination for repeated late payment or nonpayment of rent in normal fashion, but evictions require court action. Evictions, three-month stays and relief actions are within the discretion of the court. Borrowers may not evict affected tenants without prior court approval.

B. All tenants affected by the Soldiers' and Sailors' Civil Relief act are to be recertified (upon receipt of their military orders) in accordance with RD Instruction 1930-C, in order to reflect their true rent contribution. Recertification should include all income such as severance pay, salary, reservist pay, housing allowance, etc. Hazard duty pay is not counted. Upon completion of tenant recertification, rents will be increased or decreased. Tenant recertification may be processed by the co-tenant, spouse or guardian during the period of military service.

Example: If a tenant was contributing $275.00 (basic rent) per month towards rent, and their salary has decreased or increased due to leaving a previous position for military service, the new contribution towards rent may be significantly decreased or increased. If a tenant's salary decreased so low that their rent contribution falls below basic rent, the Rental Assistance (RA) allowance will increase. If no RA is available for the unit, the tenant, like other tenants without RA, will pay the basic rent.

C. Single soldiers should be encouraged to place their personal belongings and furnishings in storage for safekeeping. Monthly rents would be due as scheduled. However, if a single tenant elects to leave their belongings in the apartment, they should be encouraged to grant a power of attorney to a competent person, and provide the manager with pertinent information concerning this person. If a single person does leave their furniture on the premises and rent is delinquent, the borrower should make application to the court for authorization to act.

SECTION 3: OCCUPANCY POLICIES AND OCCUPANCY RULES *[7 CFR 3560.157]*

6.13 OCCUPANCY POLICIES

The purpose of the occupancy policy in a multi-family property is to establish:

- Unit density standards; and
- Procedures for assigning units.

A. Unit Density Standards

Occupancy policies set standards regarding the number of people that can be adequately housed in a unit of a particular size. In developing the occupancy policy for each unit, the borrower must take into account the following:

- State and local codes regarding the number of persons permitted to dwell in a unit of a particular size;
- The size of the rooms in the particular unit;
- Procedures for sizing households for different unit types (how to consider temporarily absent household members); and
- The order in which the property will house eligible applicants and rehouse existing tenants.
- A tenant who is disabled will not be considered over housed if the tenant requests an additional room for a live-in aide or an apparatus related to the tenant's disability.

For some properties, state and local codes regarding occupancy standards may not exist. In these cases, the borrower should make a judgment as to how many people may be adequately housed, basing it on the square foot size and layout of the unit. For example, some properties may have several types of two-bedroom units. If one is 600 square feet and the second type is 900 square feet, the borrower may have different occupancy policies for the different unit types. An example of what an occupancy policy might look like for the above example is detailed below:

Unit Type	Minimum Density	Maximum Density
2 Bedroom (600 sq. feet)	1 person	3 persons
2 Bedroom (900 sq. feet)	2 persons	4 persons

The following is an ideal range of persons per housing unit:

Number of Bedrooms	Occupancy Density Range	
	Minimum	Maximum
0	1	1
1	1	2
2	2	4
3	3	6
4	4	8
5	5	10

B. Procedures for Assigning Units

Occupancy policies also establish the order in which eligible applicants and existing tenants will be housed or rehoused.

Borrowers are required to comply with Section 5 of this chapter in selecting and assigning applicants to new units or relocating over- or under housed existing tenants. However, it is important that these requirements are detailed in the borrower's occupancy policies, so that it is clear to new applicants and existing tenants how a vacant unit will be assigned.

6.14 AGENCY REVIEW AND MONITORING OF OCCUPANCY POLICIES

The Agency must concur with the borrower's occupancy policies prior to initial occupancy of the project and in all future modifications. In reviewing the policies, the Agency must assure that the standards are in compliance with state and local laws and that they appear reasonable based on the unit size and type. The Agency should review compliance with the policies during the compliance review. If a household is residing in the property and is out of compliance with the occupancy policy, the borrower must follow procedures outlined in Paragraph 6.29 for tenants in violation of occupancy rules.

6.15 OCCUPANCY RULES

The purpose of the occupancy rules is to establish the basis for the tenant and management relationship.

A. Basic Rules

Exhibit 6-4 lists the basic items that borrowers must address in the occupancy rules for their projects.

Occupancy rules for each project will be in writing, attached to each tenant's lease upon initial occupancy, and posted in a central location (such as a central mail location) so that tenants may easily access the information. Modifications to these rules will be provided to the tenant at least 30 days prior to implementation and in accordance with the requirements of Section 8 of this chapter.

B. Pets

For each elderly designated multi-family housing project the borrower must have established project rules permitting elderly or disabled tenants to keep commonly accepted household pets.

Borrowers must not prohibit elderly households from keeping domestic animals in their unit; however the borrower may require the household to pay a pet deposit.

Pet rules must not:

- Prohibit, prevent, restrict, or discriminate against any tenant who owns or keeps a pet in their apartment unit, with respect to continued occupancy in the project unless the approved project pet rules are violated;
- Prohibit, prevent, restrict, or discriminate against any applicant who owns a pet with respect to obtaining occupancy in the project; and
- Charge an extra monthly rental charge for pets.

Borrowers with existing projects must consult with the tenants of the project when revising pet rules and retain documentation on how the consultation process was conducted.

Borrowers with new projects will establish pet rules prior to occupancy, but may revise those rules based on tenant comments and suggestions received after rent-up begins.

Pet rules will be reasonable and will be written to consider at least the following factors:

- Density of project units;
- Pet size;
- Type of pet;
- Potential financial obligations of tenants who own or keep pets;
- Standards of pet care;
- Pet exercise areas;
- State and local animal laws or ordinances; and
- Liability insurance.

Pet rules must allow the borrower or project manager authorization to remove from the project any pet whose conduct or condition is duly determined to constitute a nuisance or threat to the health or safety of other tenants or members in the project or persons in the surrounding community.

Exhibit 6-4

Required Items for Multi-Family Housing Occupancy Rules

At minimum, the occupancy rules should include:

- An explanation of the tenant's rights and responsibilities under the lease or occupancy agreement;
- The rent payment or occupancy charge policies;
- The policies regarding periodic inspection of units;
- The system for responding to tenant complaints;
- The maintenance request and work-order procedures;
- The project services and facilities available to tenants or members;
- The office locations, hours, and emergency telephone numbers;
- The restrictions on storage and prohibitions on abandoning vehicles in the project area;
- The way to obtain community and public transportation schedules;
- The policies regarding guests that become household members;
- Other requirements related to the subsidy provided to the tenant from non–Agency sources; and
- The procedures tenants must follow to request reasonable accommodations.

Regardless of the occupancy rules established for the project, the borrower must adhere to the following:

- Borrowers must not prohibit animals that provide assistance to the handicapped or disabled from residing in the unit with the person to whom the animal is providing assistance.

- Borrower may not require the household to pay a pet deposit for a service/assistance/companion animal.

C. Tenant Organizations

In developing and implementing the occupancy rules, borrowers must not infringe on the rights of tenants to organize an association of tenants. The project manager (or designated management representative) should be available and willing to work with a tenant organization.

Borrowers may not unreasonably withhold the use of community rooms or other available space within the project when requested by:

- A resident organization in connection with the representational functions of the organization; or

- Residents seeking to organize or to collectively consider any matter pertaining to the operation of the project.

D. Community Rooms

In developing the occupancy rules, borrowers must not place unreasonable restrictions on tenants that desire to use Federally financed community rooms for their enjoyment. While a schedule of fees may be developed for the use of the community space, fees should be reasonable and meant only to cover the costs of cleaning and maintenance of the facility being used.

6.16 AGENCY REVIEW AND MONITORING OF OCCUPANCY RULES

Borrowers must obtain concurrence from the Agency prior to the implementation of the occupancy rules, and must obtain Agency concurrence before making any modifications to the rules.

If tenants believe the borrower is in violation of occupancy rules, they must be directed to follow the tenant grievance process outlined in Section 8 of this chapter.

The Loan Servicer will review adherence to the occupancy rules during the compliance review. In a situation where the Loan Servicer believes management is in violation of the occupancy rules, the Agency must state the violation as a finding and require the borrower to resolve the problem in a specified time frame.

In situations where the tenant is in violation of the occupancy rules and the tenant fails to correct the problem, the borrower should proceed to evict the tenant for material noncompliance with the lease. In the event that an eviction action is filed with the court, the tenant should set up an escrow account for the rent.

SECTION 4: MARKETING AND APPLICATION PROCESSING
[7 CFR 3560.104 and 7 CFR 3560.154]

6.17 REQUIREMENTS FOR AFFIRMATIVE FAIR HOUSING MARKETING PLANS

Borrowers with four or more units are required to prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) using *Form HUD 935.2, Affirmative Fair Housing Marketing Plan*. The purpose of this plan is to set forth how the borrower will meet their Fair Housing responsibilities. This plan will be submitted to the Agency for approval prior to loan closing. The Agency may also require periodic modifications to the plan if implementation is not reaching the population groups targeted by the plan. At a minimum, the AFHMP will address the following:

- Outreach efforts of the property;
- Marketing strategies; and
- Education and training of all staff on Civil Rights laws (e.g., Title VI, Fair Housing, Section 504, Title IX).

The approved plan must be posted by the borrower in a prominent location for public inspection. This could include the project site, the rental office, or other location where applications are received for the property.

The borrower must develop and maintain a system for conducting self-assessments of the property staff's performance in implementing an approved AFHMP.

6.18 APPLICATION REQUIREMENTS AND PROCESSING

The purpose of the tenant application process is to collect enough information regarding the household status to determine applicant eligibility for the specific property. This information should also be comprehensive enough for the borrower to make a determination about waiting list placement.

A. Application Forms

Borrowers may develop their own application form in accordance with the requirements of Exhibit 6-5. The borrower must retain application forms for at least three years or until the next compliance review is conducted by the Agency.

Exhibit 6-5

Minimum Requirements for a Tenant Application

- Name and present address;
- Household income information, including all information from sources that would be counted in calculating annual income, adjusted income, and net assets; and consent to release wage matching data to RHS and the borrower
- Number of household members, including all members who would live in the dwelling unit, even those who would only live there on a part-time basis, and their birthdates;
- Indication of a need for a handicap accessible unit and/or handicap or disability adjustments to income;
- Applicant certification that the unit will serve as the household's primary residence;
- Social Security Number for all member of the household;
- Adjustments to income for which the household may qualify, which should be verified;
- Signature and date;
- Race, ethnicity, and gender designation; and
- Disclosure notice.

Borrowers using application forms must establish a section at the end of the form, below the signature and date block, to collect race/national origin/gender information. To meet the requirements of Federal Register Vol. 62 No. 210, Revision to the Standards for the Classification of Federal Data on Race and Ethnicity, the data collection needs to appear as follows:

"The information regarding race, ethnicity, and sex designation solicited on this application is requested in order to assure the Federal Government, acting through the Rural Housing Service that the Federal laws prohibiting discrimination against tenant applications on the basis of race, color, national origin, religion, sex, familial status, age, and disability are complied with. You are not required to furnish this information, but are encouraged to do so. This information will not be used in evaluating your application or to discriminate against you in any way. However, if you choose not to furnish it, the owner is required to note the race, ethnicity, and sex of individual applicants on the basis of visual observation or surname.

Ethnicity:

Hispanic or Latino____

Not Hispanic or Latino____

Race: (Mark one or more)

1 American Indian/Alaska Native____

2 Asian____

3 Black or African American_____

4 Native Hawaiian or Other Pacific Islander____

5 White_____

Gender: Male_____ Female_____"

The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form available in the Servicing Office.

Borrowers must establish and maintain a specific place and time where applications will be accepted. This information should be posted in a central location on the property. It must also be documented in the Management Plan and the AFHMP and to the greatest extent possible communicated through outreach and marketing efforts.

Applicants are to be provided a list of any additional information that must be submitted with the application for the application to be considered complete (an application will be considered complete without verification of the applicant information). The list of information must be restricted to the same items for all Agency-assisted properties of a particular type, such as a family or elderly complex.

B. Application Fees

Application fees are discouraged, but when used, any fee charged to an applicant must be limited to the cost of actual services incurred for obtaining necessary information associated with completing a tenant certification.

C. Maintaining Waiting Lists

When an applicant has submitted an application form the borrower must place the applicant on the waiting list. All applications, whether complete, eligible, or ineligible, will be placed on the list. The waiting list will document the final disposition of all applications (rejected, withdrawn, or placed in a unit).

The date and time a complete application was submitted will be recorded on the waiting list and will establish priority for selection from the list. If an applicant submits an incomplete application they must be notified in writing within 10 days of the items that are

needed for the application to be considered complete and that priority will not be established until the additional items are received.

The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form.

1. Electronic Waiting Lists

Electronic waiting lists must have a mechanism for maintaining the date and time of each applicant's placement on or selection from the waiting list and a way to document changes made to the list. The following are examples of methods that borrowers might use to track inputs to the electronic waiting list and changes to it:

- Use a data backup function to record the time and date of entry of new applications and changes to existing records in the electronic waiting list.

- Print a record of the appearance of the waiting list as often as necessary (at least monthly) to show each applicant's placement on and selection from the list. The time and the date of the printout should appear on the report. The owner can file this information in the tenant file and in a central waiting list file.

- Whenever status changes occur, such as changes in family composition and unit size, record the change with an explanation, and print the re-sorted list.

To the extent possible, the borrower should use electronic safeguards, such as assigning waiting list password access only to individuals responsible for maintaining the system. Ideally, a system should record the user name and the time, date, and action entered whenever a record is changed or entered in the electronic waiting list.

2. Selecting Applications from the Waiting List

Once an applicant has submitted a complete application and signed a form authorizing the borrower to verify employment, the date and time must be recorded on the waiting list to establish priority for selection. Selection from the waiting list will be made according to date and time in the following order:

- Very low-income applicants;

- Low-income applicants; and

- Moderate-income applicants.

See Paragraph 6.3 for information regarding how to determine the specific income level of an applicant.

Within 10 calendar days of receipt of a complete application, the borrower must notify the applicant in writing that he has been selected for immediate occupancy, placed on a waiting list, or rejected.

The procedures used by the borrower to purge the project's waiting list must be described in the project's management plan. These procedures must be based on the length of the waiting list or the extent of time the applicant will be expected to wait for housing.

6.19 REJECTION OF APPLICATIONS

Borrowers may deny admission for criminal activity or alcohol abuse by household members.

Borrowers are required to notify all applicants in writing of their ineligibility. If applicants are determined to be ineligible, the rejection letter must outline the reason for rejection of the application and their right to appeal such a decision in accordance with 7 CFR 3560.154 and 7 CFR 3560.160. The rejection letter must advise the applicants of their right to appeal the decision within 10 calendar days, as well as the right to a hearing. If the project is located in an area with a high concentration of non–English-speaking individuals, the letter must be in English and the non–English language that is prevalent in the area. When an applicant is rejected due to credit bureau reporting information, the source of the credit bureau must be revealed to the applicant in accordance with the Fair Credit Reporting Act.

6.20 AGENCY REVIEW AND MONITORING OF APPLICATION PROCESSING

In reviewing the application process employed by the borrower, the Agency should review the following:

- Is adequate documentation available to determine compliance with applicant processing requirements?
- Are applicants properly informed of where and when applications may be obtained and submitted?
- Does the application provide the borrower with adequate information to determine the applicant's place on the waiting list?
- Is there an element in the application process that discourages targeted populations from submitting an application? If so, will modifying the application process encourage targeted, but underserved populations to apply?
- Are applications processed in a timely manner?
- Are ineligible applicants adequately notified of their appeal rights under Section 8 of this chapter?

Loan Servicers should review the application during the compliance review to ensure that adequate information is being obtained and that the above-listed questions are answered to the satisfaction of the Agency.

SECTION 5: TENANT SELECTION AND UNIT ASSIGNMENT
[7 CFR 3560.154 AND 7 CFR 3560.155]

6.21 ASSIGNING AN AVAILABLE UNIT

Once a unit becomes available, the borrower must decide who is entitled to that unit based on a variety of factors.

Eligible tenants residing in the property who are either under- or over-housed receive priority over new applicants if relocating them into the newly vacant unit would bring the household into compliance with the occupancy policy for the property. If there are no such over- or under-housed existing tenants, the borrower must select a new applicant from the waiting list to fill the newly vacant unit. The borrower must use the project's occupancy policy to look at applicants on the waiting list who are eligible based on the unit size. From that universe, the borrower must then determine, based on income levels and priorities, which applicant is entitled to the unit. The order in which applicant households are entitled to housing depends on two factors:

- The income level of the household; and
- The priorities for which the household may qualify.

When an applicant first submitted an application, the borrower made an initial determination as to whether the household was very low-, low-, or moderate-income. Based on this assessment, the applicant was assigned to the very low-, low-, or moderate-income waiting list. When looking for the next eligible tenant for the vacant unit, the borrower must first go to the very-low income waiting list. If there are no applicants on the very low-income waiting list who qualify for the vacant unit based on the property's occupancy policy, then the borrower may go to the low-income waiting list. Only if there are no eligible applicants for the unit on the low-income waiting list may the borrower select an eligible applicant from the moderate-income waiting list.

6.22 PRIORITIES FOR UNITS

A. Exceptions to Income Standard Assignment Policies

While the basic standard is to house all very low-income applicants prior to low- and then moderate-income applicants, there are situations where this process may be bypassed. However, an individual in one of the situations identified below would not be eligible for housing before applicants on the waiting list for a lower income category.

- If the unit is a handicapped accessible unit, then an eligible household that needs the features of that unit will receive priority over all other applicants, regardless of income. If more than one applicant needs the features of the handicapped accessible unit, then applicants who are very low-income would have priority, followed by low- and then moderate-income households.

- In congregate housing facilities, applicants who qualify for and agree to utilize the services provided by the facility will be housed over all other applicants on the waiting list. Where there is more than one applicant that meets this criterion, the applicants meeting this condition will be ranked by very low-, low-, and moderate-income and housed in accordance with the occupancy policies established at the property.

- Borrowers with projects receiving low-income housing tax credits (LIHTCs), may leave a housing unit vacant if they are required to rent the available unit to an LIHTC-eligible applicant, and none of the applicants on the waiting list meet the applicable LIHTC eligibility requirements.

Example— Exceptions

Project B has two handicap-accessible units. There are three handicapped individuals who need the features of the handicap-accessible units on the waiting list: one moderate income and two low-income. The property has a waiting list of 20 very low-income applicants. The borrower must rent the two handicap-accessible units to the two low-income applicants.

Project Z is a congregate housing facility and has a vacant one-bedroom unit. There are three individuals eligible for a one-bedroom unit on the waiting list: two very low-income applicants and one low-income applicant. All qualify for congregate care services. Only one of the very low-income applicants, however, would agree to use the congregate care facilities. The borrower would have to offer one of the vacant units to the very low-income applicant who agrees to use the services and the other unit to the low-income applicant who agrees to use the services.

- Letter of Priority Entitlement (LOPE), *Handbook Letter 201*. A letter issued by the Agency providing a tenant with priority entitlement to rental units in other Agency-financed housing projects for 120 days from the date of the LOPE. Persons displaced by Agency action, or displaced persons in a Federally declared disaster area have priority over all other applicants of the individual applicant's income group

Example

Project C has a vacant three-bedroom apartment. There are no applicants eligible for a three-bedroom unit on the very low-income waiting list. There are 20 applicants eligible for a three-bedroom unit on the low-income waiting list. A holder of a LOPE applies for occupancy at the project. The applicant is low-income and qualifies for a two-bedroom unit. Despite the number of applicants on the waiting list, the borrower must offer the available unit to the LOPE holder, and the LOPE holder agrees to move to the appropriate-size unit when one becomes available.

B. Assignment of Rental Units Accessible to Individuals with Disabilities

If a rental unit accessible to individuals with disabilities is available and there are no applicants that require the features of the unit, the borrower may rent the unit to a non-disabled tenant under the following conditions:

- The borrower must include a provision in the lease requiring the tenant to vacate the unit within 30 days of notification to an appropriate sized vacant unit within the project, if one is available from management that an eligible individual with disabilities requires the unit;
- The unit has been marketed as an accessible unit;
- Outreach has been made to organizations representing the disabled; and
- Marketing of the unit as an accessible unit continues after it is rented to a tenant who is not in need of the special design features.

Borrowers receiving HUD Section 8 project-based assistance may establish preferences in accordance with HUD regulations. The use of such preferences must be documented in the project's management plan.

6.23 AGENCY MONITORING AND REVIEW OF UNIT ASSIGNMENT

The selection and assignment of units is one of the most important aspects to managing a property. Borrowers and management agents must assure onsite management staff are well versed in Agency policy and guidance regarding this subject or require the borrower to modify the management plan to reflect increased training in this area. The Loan Servicers will review the waiting lists and completed applications to ensure that:

- Units which are not needed to relocate existing tenants are first offered to eligible very low-income families; and
- Units are offered to households in accordance with the borrower's occupancy policy.

If Loan Servicers find that the borrower or the agent is failing to follow Agency policy in assigning available units, Loan Servicers may require the borrower modify the management plan to clearly reflect Agency policy and/or enhance the training of management staff responsible for assigning units.

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SECTION 6: DWELLING LEASES *[7 CFR 3560.156]*

6.24 OVERVIEW OF DWELLING LEASES

A lease between the borrower and the tenant is required to be executed before any tenant occupies a unit in a multi-family housing project. This section will provide information regarding how the borrower will develop that lease and what action is needed by the Agency before the lease may be used. The Agency must approve the lease before the borrower enters into a lease agreement with any tenant.

6.25 DEVELOPMENT OF A LEASE

The borrower is responsible for the development of the tenant lease that will be used at the property. This lease must contain the required items, provisions and clauses outlined in **Attachment 6-E** and must be free of prohibited clauses listed in **Attachment 6-F**. It must also be in compliance with state and local laws. If there are conflicting requirements between Federal, state, and local laws, the borrower must notify the Agency of the conflict and request guidance. Once a lease is developed by the borrower, the borrower's attorney must certify that the lease is in compliance with the requirements of 7 CFR 3560.156 and **Attachments 6-E** and **6-F** prior to submission of the lease to the Agency for approval. The Agency must approve with all leases proposed for use at an Agency-related property, prior to the use of that lease.

6.26 EXECUTION OF THE LEASE WITH THE TENANT

Prior to the occupancy of any unit by an applicant, the applicant and the borrower must execute a lease that has been approved by the Agency. Once a lease has been executed with the applicant, they are entitled to occupy the unit so long as they remain eligible and comply with lease renewal requirements. Expiration of the lease is not of itself grounds for a termination of tenancy.

6.27 AGENCY REVIEW AND MONITORING OF LEASE REQUIREMENTS

The management agent must review and monitor the implementation of the lease with the applicant/tenant to ensure that they are properly informed of their rights and responsibilities under the lease. During the compliance review process, the Agency should look to assure:

- The occupancy rules are attached to the initial lease;
- The applicant understands their rights to the tenant grievance process under HUD Section 8 and 7 CFR 3560.160; and
- The applicant understands the process for relaying information such as maintenance requests and income information to management and the responsibility to do so in a timely manner.

If the Loan Servicer finds the borrower is failing to provide adequate information regarding the rights and responsibilities of the tenant and the management agent, the Loan Servicers should require the borrower to improve the management plan and training of onsite staff.

SECTION 7: TENANT RECERTIFICATION AND CHANGES IN ELIGIBILITY *[7 CFR 3560.152 and 7 CFR 3560.158]*

The recertification process developed in this section is designed to ensure a tenant remains eligible to reside in multi-family housing. As household status changes, the size of the unit needed by the household or the amount of rent that they are obligated to pay may change. This section discusses when a recertification is required and what action the borrower will be required to take if a household is determined ineligible to continue residing at the property.

6.28 REQUIREMENTS TO RECERTIFY TENANTS

A. The Annual Recertification Process

Each time a resident is recertified, the certification is good for one year, unless subpart 2 of this paragraph requires a recertification to be completed more frequently. At the end of the year the certification will expire and the borrower is required to recertify the household. The effective date of the tenant's recertification is the first day of the month following the expiration of the current certification. Using the procedures outlined in Section 1 of this chapter, the borrower will complete a new certification. The key steps to this process include:

1. Notifying the Tenant of the Recertification Requirement

At least 75 to 90 days prior to the date that the certification expires, the borrower must notify the tenant in writing that they must be recertified to remain eligible to continue residence at the property. This letter will also include what information the borrower needs from the household in order to complete the certification.

If the household still fails to respond to the letter, the borrower should issue a second letter 30 days prior to the date which the certification expires informing the tenant of the:

- Information needed to recertify;
- The time frame in which the new certification must be submitted to the Agency; and
- The consequences for failure to comply with the recertification process.

2. Execution of the New Certification

Upon receiving the information regarding household size and income from the tenant, the borrower will verify the information and the borrower and the tenant will complete a new *Form RD 3560-8*. This form will document the calculation of annual income and adjusted income (in accordance with Section 1 of this chapter) and the calculation of the tenant payment (in accordance with Chapters 7 and 8).

B. Interim Recertification Process

Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of $100 or more per month occurs. Borrowers must recertify for changes of $50 per month, if the tenant requests that such a change be made.

1. Tenant Requirements

- Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.

- Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.

- Tenants must report all changes in household status that may affect their eligibility to borrowers.

- Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in 7 CFR part 3560, subpart O.

2. Borrower Requirements

- Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.

- Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or net tenant contribution.

- Borrowers must submit initial or updated tenant certification forms to the Agency within <u>10 days</u> of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a <u>first day of the month.</u>

- Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in Paragraph 6.27 B of this section will be charged overage, as specified in 7 CFR 3560 203(c). Unauthorized assistance, if any, will be handled in accordance with 7 CFR part 3560, subpart O.

- Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.

- Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency supervisory visit, whichever is longer.

- The Agency maintains the right to independently verify tenant eligibility information.

C. Submission of the Certification to the Agency

Once the borrower and the tenant execute a certification, it must be submitted to the Agency within 10 days of the effective date of the certification. In order for a certification to be valid, it must be signed and dated by all parties on or before the effective date and maintained in the tenant file. If a borrower fails to submit a certification by the effective date, it will result in monetary penalties to the borrower as established in Chapter 7.

6.29 AGENCY REVIEW AND MONITORING OF THE RECERTIFICATION PROCESS

A. Agency Review

The recertification process is designed to ensure that Agency programs are serving income-eligible households on an ongoing basis. Loan Servicers review of the recertification process should be designed to ensure that recertifications are executed in a timely manner. The Loan Servicers should make the following assessments:

- Are tenants receiving the proper notice—at least 90 days in advance of the expiration of the current certification?

- Does the notice provide the tenant with a list of the information needed for the completion of the recertification process?

- Are borrowers accurately determining when an interim recertification is needed?

- Are interim recertifications being executed on a timely basis (i.e., no later than 30 days from the time the information is provided to the borrower)?

- Does the certification form provide the information needed by the Agency to determine that the tenant payment and rental subsidy have been calculated correctly?

- Is the borrower completing the verification of information on a timely basis?

If the Loan Servicer concludes that the borrower is deficient in recertifying existing tenants, the Agency must require the borrower and the management agent to modify existing practices and procedures to ensure a more timely delivery of recertifications to the Agency. This could include:

- Modification of the management plan to incorporate stronger or more specific procedures with regard to recertifications;
- Enhanced training for onsite staff in processing Agency certifications; and
- Stronger enforcement of the penalties for tenants who fail to comply with the recertification process.

B. Management Agent Interactive Network Connection (MINC)

MINC is the mechanism by which borrowers submit tenant certifications to the Agency electronically on a monthly basis.

Within twelve months of the date of publication of the interim final regulation, for projects with eight units or more, all borrowers will be required to submit tenant certifications through MINC. The Agency may make an exception to this requirement if the borrower submits documentation that the costs associated with electronic submission of tenant certifications would pose a financial hardship to the project.

If the borrower is using MINC, certifications must be submitted by the tenth of the month for which they are due. For instance, if the borrower is submitting certification due in May with an effective date of May 1, the certifications must be electronically transmitted to the Agency by May 10. If for any reason the borrower is unable to transmit the certifications electronically during a given month, the borrower must submit the hard copies of the certifications to the Agency for receipt by the tenth of the month.

Borrowers who are not using MINC must either submit certifications by diskette or hard copies to the Agency for receipt by the tenth of the month.

Regardless of the transmission method used—MINC or hard copies—if the Agency does not receive certifications by the tenth of the month in which they are due and the borrower has not notified the Agency that the transmission will be late; the borrower will be subject to overage penalty.

Attachment 6-G provides guidance on the allowable sources of funds for obtaining automation capabilities.

6.30 INELIGIBLE TENANTS

Ineligible tenants are those who, upon recertification, fail to meet either the income or the occupancy requirements for the unit and property that they currently occupy. Regulations require that tenants who are no longer eligible to reside at the property be given notice that they must vacate the property within 30 days or at the end of their lease, whichever is longer.

A. Continuation of Tenancy—Tenants Who Fail to Comply with the Occupancy Policy

In some situations, a tenant may be ineligible based on the size of the unit currently occupied, but could become eligible if shifted to a unit of a different size (either larger or smaller) within the property. In this situation, a tenant may continue tenancy as an ineligible tenant, but the borrower should relocate the household to the proper unit size as soon as a unit of that size becomes available.

In some cases, a household may require a unit size that is unavailable at the property. In this situation the tenant would be considered ineligible and required to vacate the property within 30 days or at the end of their lease, whichever is longer.

B. Continuation of Tenancy—Tenants Who Fail to Comply with the Income Requirements for the Property

In most cases, if tenant certifications indicate that they no longer comply with the income limits set for the property, tenants must be notified about vacating the property in 30 days or at the end of their lease, whichever is longer.

In two specific situations, borrowers may permit ineligible households to reside at the project with prior Agency approval:

- The waiting list for the specific unit type has no eligible tenants; or
- The required time period for vacating the unit would create a hardship on the household.

Elderly households with incomes above the moderate-income level may occupy projects with an Agency loan approved prior to 1968 with a loan agreement that does not restrict occupancy by income.

C. Cooperative Members

Any persons who are eligible members of a cooperative will not be considered ineligible or subsequently deprived of their membership by reason of no longer meeting the income-eligibility requirements as defined in 7 CFR 3560.152.

D. Remaining Household Members

Members of a household residing in a multi-family housing project may continue to occupy the unit after the departure of the original tenant, regardless of age, provided that:

- They are eligible with respect to income;
- They were either a cotenant or member of the household, have the legal capacity to sign the lease, and are U.S. citizens or qualified aliens;

- They occupied the unit with the original tenant at the time the original tenant died or departed;
- They sign a new tenant certification establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Remaining household members that are over housed must move to a suitably sized rental unit within 30 days of its availability. If a suitably sized unit does not exist at the property, the tenant will be required to vacate the property in accordance with Paragraph 6.32 A.

E. Surviving Household Members

Members of an elderly household residing in an elderly project may continue to occupy the unit after the death of the original tenant, regardless of age, provided that:

- They are eligible with respect to income;
- They were either a co-tenant or member of the household and have the legal capacity to sign the lease;
- They occupied the unit with the original tenant at the time the original tenant died or departed;
- They sign a new tenant certification establishing their own tenancy; and
- They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

Surviving household members who are over housed may remain in the unit, but must move to a suitably sized rental unit within 30 days of its availability. If a suitably sized unit is not available, surviving household members may remain in the rental unit according to the housing project's occupancy rules as follows:

- Continued occupancy of the rental unit will not be allowed when:
  - ◊ The rental unit has accessibility features for individuals with disabilities;
  - ◊ The household no longer has a need for such accessibility features; and
  - ◊ The housing project has a tenant application from an individual with a need for the accessibility features.
- If the housing project does not have a tenant application from an individual with a need for the accessibility features, the household may remain in the rental unit until the housing project receives an application from an individual in need of the accessibility features, at which point, the household will be required to move within 30 days; and

- If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until a unit becomes available, and must then move within 30 days.

F. Agency Review and Monitoring of Ineligible Tenants

For an ineligible tenant to remain at the property beyond the allowable time frame of 30 days or the end of the lease, whichever is longer, the borrower must obtain written permission from the Agency. In granting such permission, the Agency should assure that one of two criteria exist:

- The waiting list for the specific unit type has no eligible tenants; or

- The required time period for vacating the unit would create a hardship for the household.

In reviewing whether the borrower is in compliance with the requirements to remove ineligible tenants the Agency should check to ensure:

- The borrower is requesting approval for ineligible tenants to remain on the property in a timely manner.

- The borrower is properly documenting any reason for which an ineligible tenant is being allowed to continue to reside in the property. Some of these reasons may include:

  ◊ Permission has been granted by the Agency for the tenant to remain temporarily;

  ◊ The tenant is a surviving member of an elderly household; or

  ◊ The household is still income eligible and will be moved to an appropriate-size unit when one becomes available at the property.

- The borrower is providing proper notice to tenants regarding the time frames for vacating the property.

6.31 LEASE VIOLATIONS

Borrowers may require tenants in violation of occupancy rules or the terms of their lease to vacate the property in accordance with the terms of their lease agreement. However, borrowers must provide notice to such tenant in a format that is in compliance with state and local laws and is approved by the Agency.

6.32 TERMINATION OF OCCUPANCY

A. Tenants in Violation of the Lease

In accordance with the lease, a borrower may terminate or refuse to renew a tenant's lease for material noncompliance with the lease or occupancy rules or for other good cause. Material noncompliance with lease provisions or occupancy rules includes actions such as:

- Violations of lease provisions or occupancy rules that are substantial and repeated;
- Nonpayment or repeated late payment of rent or other financial obligations due to the borrower; and
- Admission to or conviction for use, attempted use, possession, manufacture, sale or distribution of an illegal controlled substance. Such activity must have occurred on the project's premises by the tenant, a member of the tenant household, or any other person under the tenant's control at the time of the activity.

For purposes of terminating a tenant's occupancy, good cause includes actions by the tenant or member of the tenant's household that:

- Threaten the health and safety of other persons or the right of other persons to peaceful enjoyment of their dwelling;
- Result in substantial physical damage causing an adverse financial effect on the housing or other persons' property; and
- Are actions prohibited by state or local law.

If the borrower terminates the tenant's lease, the borrower must document in writing in the tenant's file:

- The incidences related to the lease; and
- That the tenant was given notice prior to the termination that the tenant's activities would result in occupancy termination.

Prior to terminating a lease, the borrower must give the tenant written notice of the violation and give the tenant an opportunity to correct the violation. Subsequently, termination may only occur when the incidences related to the termination are

documented and there is documentation that the tenant was given notice prior to the initiation of the termination action that their activities would result in occupancy termination.

B. Other Lease Terminations

A landlord may terminate occupancy for conditions beyond the tenant's control, such as:

- Required repair or rehabilitation of the building; or
- Natural disaster.

Under these circumstances, the affected tenants may request a LOPE from the Agency. The LOPE will provide the tenant with priority entitlement to rental units in other Agency-financed projects for 120 days from the date of the LOPE. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period. Tenants that are displaced due to circumstances beyond their control are entitled to benefits under the Uniform Relocation Act.

SECTION 8: TENANT GRIEVANCE PROCEDURES *[7 CFR 3560.160]*

This section presents the process for resolving tenant grievances. Every step of the process will be explained with the responsibilities of each party involved. Topics covered in this section include when to file a complaint, the hearing process, requirements governing the hearing, and the hearing decision. It is important to note that a resolution that is in the best interest of everyone should have gone through the entire grievance process before a final decision was made.

Tenants or prospective tenants may file a grievance in writing with the borrower in response to a borrower action, or failure to act, in accordance with the lease or Agency regulations that results in a denial, significant reduction, or termination of benefits or when a tenant or prospective tenant contests a borrower's notice of proposed adverse action as provided in Paragraphs 6.31 and 6.32.

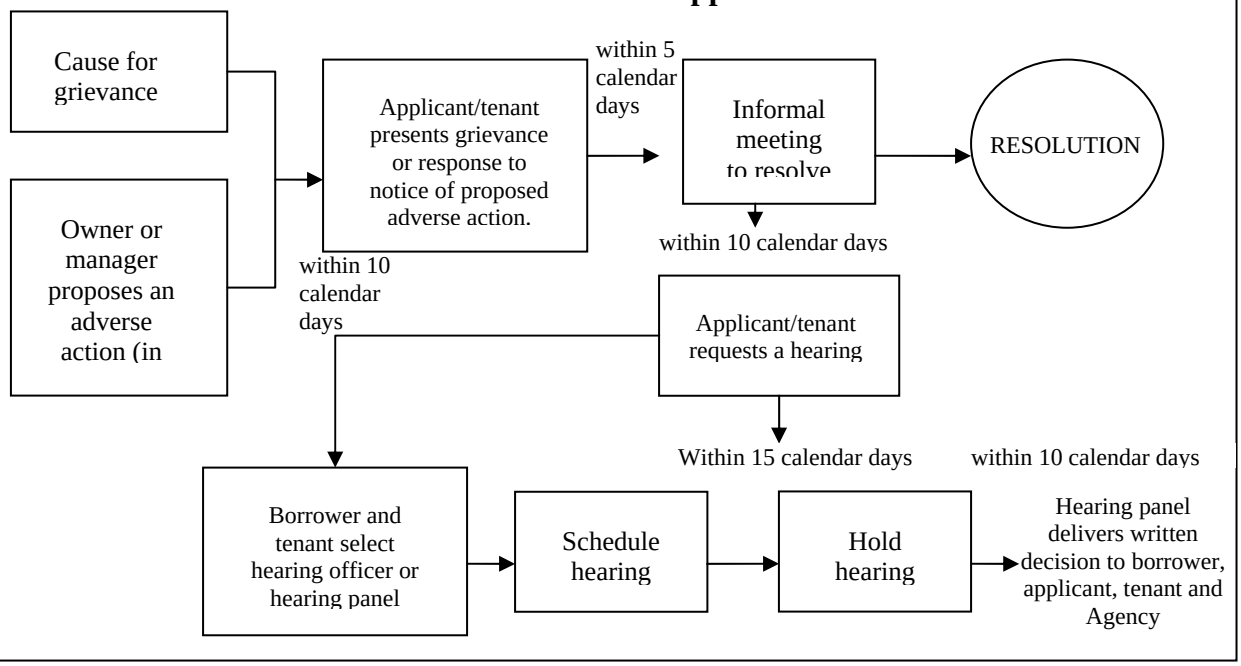
6.33 NOTICE OF ADVERSE ACTION

In the case of a proposed action that may have adverse consequences for tenants or prospective tenants such as denial of admission to occupancy and changes in the occupancy rules or lease, the borrower must notify the tenant or prospective tenant in writing. The notice must give specific reasons for the proposed action. The notice must also advise the tenant or prospective tenant of "the right to respond to the notice within 10 calendar days after date of the notice" and of "the right to a hearing in accordance with 7 CFR 3560.160 (f), which is available upon request." The notice must contain the information specified in 7 CFR 3560.160 (a)(2). For housing projects in areas with a concentration of non-English-speaking individuals, the notice must be in English and the non-English language.

6.34 OVERVIEW OF THE PROCESS

The grievance process should always begin with an informal meeting between the grieved party and the borrower/management agent. It is the Agency's belief that the best way to resolve grievances is through an informal meeting between the two parties. Borrowers must offer to meet with tenants to discuss the grievance within 5 calendar days of receiving the grievance. If an informal meeting is held, the borrower must provide a summary of the meeting to the tenant within 10 calendar days of the meeting date. The Agency encourages borrowers and tenants or prospective tenants to make an effort to reach a mutually satisfactory resolution to the grievance at the meeting.

Exhibit 6-6
The Grievance and Appeals Process



The parties will select a hearing panel or hearing officer to govern the hearing. Within 10 calendar days after the hearing, all parties are informed of the decision. Exhibit 6-6 provides an example of the grievance process.

6.35 WHEN IS A TENANT GRIEVANCE LEGITIMATE?

It is important for the management agent to determine if a tenant or prospective tenant's grievance is within the requirements established for the program. For example, "I want to file a complaint because the manager does not speak to me," is not a legitimate complaint. On the other hand, a complaint that the building manager fails to maintain the property according to the Agency guidelines is a legitimate complaint. Exhibit 6-7 lists the circumstances in which a tenant may or may not be able to file a complaint.

Exhibit 6-7

Tenant Complaints—Allowable Circumstances

A complaint may NOT be filed if:	***A complaint MAY be filed if:***
• There is a proposed rent change that is authorized by the Agency. • A tenant or prospective tenant believes that they have been discriminated against. If a person believes that discrimination has occurred, they should file a complaint with the USDA's Office of Civil Rights or the Secretary of HUD. • A project has formed a tenant's association and all parties involved have agreed to use this association as a method of settling grievances. • There are changes in the rules that are required by the Agency and proper notice has been given. • The tenant is in violation of the lease and those violations result in termination of tenancy. • Disputes between tenants that do not involve the borrower/management agent. • Displacement or other effects as a result of prepayment.	• There is a modification of the lease, change in the rules, or changes in the rent that are not authorized by the Agency. • The borrower/management agent fails to maintain the property in a manner that is decent, safe, and sanitary. • The borrower violates a lease provision or occupancy rule. • Denial of admission to the project by a prospective tenant.

6.36 BORROWER/MANAGEMENT AGENT RESPONSIBILITIES

The borrower/management agent is responsible for providing all tenants and prospective tenants with decent, safe, and sanitary housing. The following is a list of all of the responsibilities of the borrower/agent:

- Post all regulations, summary of regulations, or tenant information, including the equal housing opportunity poster, "and justice for all" poster, tenant grievance and appeals procedures, the AFHMP, occupancy rules, and office and emergency hours and phone numbers in a conspicuous place.

- Provide all tenants with a summary of their rights at the time the lease is signed and at each lease renewal. For tenants that are currently living in the project, a summary must be submitted once the summary is created.

- If the project has a large population of non-English-speaking tenants, the borrower/agent must provide the summary and any other documents that pertain to the tenant's rights, in the non–English language.

6.37 THE HEARING PROCESS

A. Request for a Hearing

- Each hearing process must begin with the request for a hearing. The tenant or prospective tenant must present their request within 10 days after the receipt of the summary of the informal meeting. The request must contain the following information:

  ◊ The reason for the grievance or contest of the borrower/management agent's proposed action;

  ◊ The action relief sought; and

  ◊ Additional information.

- If the tenant or prospective tenant's request for a hearing is not received within the given time, the borrower or management agent's decision will become final.

B. Scheduling the Hearing

The hearing must be scheduled within 15 days after the receipt of the tenant's request for a hearing. If a hearing officer or hearing panel must be selected, the hearing will be scheduled within 15 days after the selection or appointment of a hearing officer or hearing panel. It is the responsibility of the two parties to agree upon a place and time that is mutually convenient to hold the hearing. If the two parties cannot agree on a place and time, it will become the responsibility of the hearing officer or hearing panel to make the decision.

C. Selection of the Hearing Officer or Hearing Panel

The two parties must select a hearing officer. If the hearing officer cannot be agreed upon, the two parties will choose members to serve on the hearing panel. The hearing panel should consist of three members. The tenant and the borrower/management agent will each elect one person to the panel. It is then the responsibility of the two chosen members to elect a third member to the panel. If within 30 days from the time the request for the hearing was submitted a hearing panel has not been formed, the borrower/ management agent must inform the Agency. Within 10 days of reviewing the facts, the Agency must appoint a hearing officer. Once a hearing officer or panel is selected the Agency must inform them in writing of their responsibilities for conducting the hearing.

Some helpful information that should be remembered by all parties involved in the process when selecting a hearing officer or hearing panel includes:

- Hearing panel members should be impartial, disinterested persons;

- The hearing officer cannot be a person previously considered by the tenant or borrower/management agent; and

- The hearing officer cannot be an Agency staff member.

Potential Hearing Panel Members

1. Legal aid counsel;
2. Someone with knowledge of the program; or
3. A Minister.

- The hearing officer may not receive any payment unless that payment is made by the Agency.

To minimize time and the level of effort, a management agent may elect to have a standing hearing panel for each project that they manage. If a standing panel is chosen, the above-listed process will have to be forfeited in lieu of the following process.

- A hearing panel consists of three members: one tenant panelist, one borrower/management agent panelist, and a chair.

- Tenants will get to nominate and vote for their panel members. A meeting must be held to allow the tenants the opportunity to choose two members to serve on the standing panel; one member will serve as the alternate. All residents should be notified of the time, date, and place where the election is going to take place. The borrower is responsible for ensuring that the notice is placed in a conspicuous place, within 2 weeks of the time the person is expected to start serving as a panel member. The meeting must also be held in a place that is convenient and accessible to the tenants.

- The borrower/management agent is responsible for selecting one or two members to serve on the standing panel. If two members are chosen, one will serve as the alternate.

- The third and "mutual" member of the panel will serve as the chair for the panel. The other two interested parties will elect the chairperson. Each party will only have the opportunity to give one vote, even if two people were elected to serve on the panel.

- Each member will serve on the panel for one year, with the opportunity for reelection. All members of the standing panel must be willing to render their services without compensation.

D. Examination of Records

At a reasonable time before the hearing, the borrower/agent must allow the tenant the opportunity to examine all files that are going to be used during the hearing. Documents can be examined and copied if:

- The tenant is willing to cover any expenses that may be incurred;
- The document, record, or policy is one that will be used during the hearing process; and
- The document, record, or policy is not subject to any laws or confidentiality agreements that prohibit reproductions.

Documents That May Not Be Copied

1. Credit reports;
2. Project budgets; and
3. Supervisory findings.

E. Escrow Deposits

Tenants may establish escrow accounts if a grievance involves a rent increase not authorized by the Agency or if the borrower/agent is not maintaining the property in a decent and sanitary manner. The escrow account will allow the tenant the opportunity to make timely rent payments without having the borrower/agent receive the payment until the grievance has been settled. To maintain an escrow account, tenants must adhere to the following rules:

- All deposits must continue until the grievance is resolved;
- The institution that the escrow account is established in must be a Federally insured institution;
- All deposits must be made on time—failure to do so will terminate the entire process and all sums will be due immediately; and
- Tenants must make all receipts of deposit available for examination by the borrower/agent.

6.38 REQUIREMENTS GOVERNING THE HEARING

The hearing is an informal proceeding at which evidence is presented to a hearing officer or hearing panel. The hearing must be designed to ensure that the rights of all parties involved are protected. The hearing must protect:

- The right of both parties to be represented by counsel or another person(s) chosen as their representative;
- The right of the tenant or prospective tenant to a private hearing unless a public one is requested;

- The right of the tenant or prospective tenant to present oral and written evidence and arguments in support of their grievance or appeal, and to refute the evidence and cross-examine all witnesses on whose testimony or information the borrower or management agent relies; and

- The right of the borrower or management agent to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to confront and cross-examine all witnesses on whose testimony or information the tenant or prospective tenant relies.

During the hearing, each party must present evidence to support their position. All participants at the hearing must conduct themselves in an orderly manner. Participants that cannot conduct themselves in an orderly manner will be excluded from the proceedings or will cause the hearing panel or hearing officer to make a decision that is not in favor of the disorderly party.

Remember

The Agency approval is only to make sure that the decision is in compliance with other Agency programs.

If the tenant or prospective tenant or management agent fails to appear at a scheduled hearing, the hearing officer or hearing panel may choose to postpone the hearing for no more than 5 days or may determine that the party has waived their right to a hearing under this subpart. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. All parties involved in the hearing must be informed of the hearing panel's decision.

6.39 THE HEARING DECISION

It is the responsibility of the hearing officer or hearing panel to prepare and submit a written decision to both parties within 10 calendar days of the hearing. The hearing officer or hearing panel must inform the Agency of the decision and the reasons for making that decision. The decision should be based on the facts that were presented during the hearing. The decision is not final until it has been approved by the Agency for compliance. This contingent form of approval should be noted in the decision letter. Upon receipt of the letter, the borrower and the tenant must comply with the directives specified in the decision.

SECTION 9: SPECIAL REQUIREMENTS FOR LABOR HOUSING *[7 CFR 3560.575 AND 7 CFR 3560.624]*

While the Agency-sponsored Labor Housing programs have similar requirements in many respects to the Rural Rental Housing programs, because the target populations that these programs serve vary, there are some differences in program rules.

This section is designed to highlight these differences with regard to the occupancy rules. Unless otherwise noted below, the requirements throughout this chapter also apply to Labor Housing projects.

6.40 OFF-FARM LABOR HOUSING

A. Eligible Tenants

Labor Housing tenants must meet all of the following criteria in order to be defined as an eligible tenant for the purposes of residing in labor housing:

- **Occupational.** An eligible household must include a tenant or co-tenant who is a domestic farm laborer, a retired or disabled domestic farm laborer, or must be a surviving household of a deceased domestic farm laborer.

- **Income.** The household must meet the definition of income eligibility as defined in Section 1 of this chapter. The current income limits for off-farm labor housing may be found in **Attachment 6-H.**

- **Occupancy.** The household must remain in compliance with the borrower's occupancy policy as established in Section 3 of this chapter.

If a household, upon recertification, is not in compliance with any of the above criteria, then it will be defined as an ineligible tenant and will be covered by Section 6.

B. Occupancy Priorities

When a borrower of a labor housing project is selecting the appropriate applicant for a vacant unit from the waiting list, the selection will be regulated by the following priorities:

- **First priority** must be given to eligible active farm laborer households, with first priority going to very low-income households, next to low-income households, and last to moderate-income households.

- **Second priority** must be given to retired or disabled domestic farm laborer households who were active in the local farm labor market area at the time of retirement or becoming disabled, with first priority going to very low-income households, next to low-income households, and last to moderate-income households.

- **Third priority** must be given to other retired or disabled domestic farm laborer households who were not active in the local farm labor market at the time of retiring or becoming disabled. Occupancy priority will be given first to very low-income households, next to low-income households, and last to moderate-income households.

Within each of the above priorities, occupancy priority within each ranking category is according to the household's income: very low, low, and then moderate.

Example

Project D has a vacant two-bedroom unit. On the waiting list, there are seven applicants eligible for a two-bedroom unit.

1. One applicant is a very low-income disabled farm laborer household from the local farm market area;
2. One applicant is a low-income active farm labor household;
3. One applicant is a low-income retired farm laborer household from another state;
4. One applicant is a very low-income retired farm laborer household from the local farm market area;
5. One applicant is a very low-income disabled farm laborer household from another county; and
6. One applicant is a very low-income active farm labor household.

The borrower must offer the vacant unit to these applicants in the following order.

1. First to the very low-income active farm labor applicant;
2. Second to the low-income active farm labor applicant;
3. Third to the very low-income disabled farm laborer household from the local farm market area;
4. Fourth to the low-income retired farm laborer household from the local farm market area; and
5. Fifth to the very low-income disabled farm laborer household from outside the local farm market area.
6. Sixth to the low-income retired farm laborer household from another state.

C. Projects with Diminished Need

When there is a diminished need for housing by persons or families who are eligible to reside in labor housing, units may be made available to persons or families eligible for occupancy under Section 1 of this chapter. Tenants admitted under this exception may occupy the labor housing until such time the units are again needed by persons or families eligible under Paragraph 6.40 A of this section. As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence.

6.41 ON-FARM LABOR HOUSING

A. Eligible Tenants

The income restrictions and occupancy priorities listed throughout this chapter do not affect the occupancy of on-farm labor housing. This housing is owned by farm borrowers and is for the purpose of providing decent, safe, and sanitary housing to the specific farmer's employees. Occupancy of on-farm labor housing owned by farm borrowers is restricted to employees of the farmer or is governed by an employment contract with the farmer.

B. Ineligible Tenants

For on-farm labor housing, ineligible occupants will include:

- The immediate relatives of the borrower(s); and
- Anyone who is not employed in domestic farm labor.

Ineligible tenants may occupy housing owned by farm borrowers with the permission of the Agency.

ATTACHMENT 6-A

ANNUAL INCOME INCLUSIONS AND EXCLUSIONS

Annual income is defined in 7 CFR 3560.153, calculating income in accordance with 24 CFR 5.609 as amended. Public Housing Authority denotes the certifying entity for Rural Development it is usually the Borrower or the Management Agent.

(a) Annual Income Means All Amounts, Monetary or Not, Which:

(1) Go to, or on behalf of, the family head or spouse (even if temporarily absent) or to any other family member; or

(2) Are anticipated to be received from a source outside the family during the 12-month period following admission or annual reexamination effective date; and

(3) Are not specifically excluded in Paragraph (c) of this attachment.

Annual income also means amounts derived (during the 12-month period) from assets to which any member of the family has access.

(b) Annual Income Includes, But Is Not Limited To:

(1) The full amount, before any payroll deductions, of wages and salaries, overtime pay, commissions, fees, tips and bonuses, and other compensation for personal services.

(2) The net income from the operation of a business or profession. Expenditures for business expansion or amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation of assets used in a business or profession may be deducted, based on straight line depreciation, as provided in Internal Revenue Service regulations. Any withdrawal of cash or assets from the operation of a business or profession will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested in the operation by the family.

(3) Interest, dividends, and other net income of any kind from real or personal property. Expenditures for amortization of capital indebtedness shall not be used as deductions in determining net income. An allowance for depreciation is permitted only as authorized in Paragraph (b)(2) of this attachment. Any withdrawal of cash or assets from an investment will be included in income, except to the extent the withdrawal is reimbursement of cash or assets invested by the family. Where the family has net family assets in excess of $5,000, annual income shall include the greater of the actual income derived from all net family assets or a percentage of the value of such assets based on the current passbook savings rate, as determined by HUD.

(4) The full amount of periodic amounts received from Social Security, annuities, insurance policies, retirement funds, pensions, disability or death benefits, and other similar types of periodic receipts, including a lump sum amount or prospective monthly amounts for the delayed start of a periodic amount (except as provided in Paragraph (c)(14) of this attachment).

(5) Payments in lieu of earnings, such as unemployment and disability compensation, worker's compensation and severance pay (except as provided in Paragraph (c)(3) of this attachment).

(6) Welfare assistance payments.

(i) Welfare assistance received by the family.

(ii) If the welfare assistance payment includes an amount specifically designated for shelter and utilities that is subject to adjustment by the welfare assistance agency in accordance with the actual cost of shelter and utilities, the amount of welfare assistance income to be included as income shall consist of:

> (A) The amount of the allowance or grant exclusive of the amount specifically designated for shelter or utilities; plus
>
> (B) The maximum amount that the welfare assistance agency could in fact allow the family for shelter and utilities. If the family's welfare assistance is ratably reduced from the standard of need by applying a percentage, the amount calculated under this paragraph shall be the amount resulting from one application of the percentage.

(7) Periodic and determinable allowances, such as alimony and child support payments, and regular contributions or gifts received from organizations or from persons not residing in the dwelling.

(8) All regular pay, special pay and allowances of a member of the Armed Forces (except as provided in Paragraph (c)(7) of this attachment).

(c) Annual Income Does Not Include The Following:

(1) Income from employment of children (including foster children) under the age of 18 years;

(2) Payments received for the care of foster children or foster adults (usually persons with disabilities, unrelated to the tenant family, who are unable to live alone);

(3) Lump-sum additions to family assets, such as inheritances, insurance payments (including payments under health and accident insurance and worker's compensation), capital gains and settlement for personal or property losses (except as provided in Paragraph (b)(5) of this attachment).

(4) Amounts received by the family that are specifically for, or in reimbursement of, the cost of medical expenses for any family member;

(5) Income of a live-in aide, as defined in 24 CFR 5.403;

(6) Subject to Paragraph (c)(16)(viii) of this attachment which applies only to Section 515 with project based Section 8 programs, the full amount of student financial assistance paid directly to the student or to the educational institution;

(7) The special pay to a family member serving in the Armed Forces who is exposed to hostile fire;

(8) Amounts received for training programs and stipends.

(i) Amounts received under training programs funded by HUD;

(ii) Amounts received by a person with a disability that are disregarded for a limited time for purposes of Supplemental Security Income eligibility and benefits because they are set aside for use under a Plan to Attain Self-Sufficiency (PASS);

(iii) Amounts received by a participant in other publicly assisted programs which are specifically for or in reimbursement of out-of-pocket expenses incurred (special equipment, clothing, transportation, child care, etc.) and which are made solely to allow participation in a specific program;

(iv) Amounts received under a resident service stipend. A resident service stipend is a modest amount (not to exceed $200 per month) received by a resident for performing a service for the PHA or owner, on a part-time basis, that enhances the quality of life in the development. Such services may include, but are not limited to, fire patrol, hall monitoring, lawn maintenance, resident initiatives coordination. No resident may receive more than one such stipend during the same period of time;

(v) Incremental earnings and benefits resulting to any family member from participation in qualifying State or local employment training programs (including training programs not affiliated with a local government) and training of a family member as resident management staff. Amounts excluded by this provision must be received under employment training programs with clearly defined goals and objectives, and are excluded only for the period during which the family member participates in the employment training program;

(9) Temporary, nonrecurring or sporadic income (including gifts);

(10) Reparation payments paid by a foreign government pursuant to claims filed under the laws of that government by persons who were persecuted during the Nazi era;

(11) Earnings in excess of $480 for each full-time student 18 years old or older (excluding the head of household and spouse);

(12) Adoption assistance payments in excess of $480 per adopted child;

(13) Deferred periodic amounts from supplemental security income and social security benefits that are received in a lump sum amount or in prospective monthly amounts;

(14) Amounts received by the family in the form of refunds or rebates under State or local law for property taxes paid on the dwelling unit;

(15) Amounts paid by a State agency to a family with a member who has a developmental disability and is living at home to offset the cost of services and equipment needed to keep the developmentally disabled family member at home; or

(16) Amounts specifically excluded by any other Federal statute from consideration as income for purposes of determining eligibility or benefits under a category of assistance programs that includes assistance under any program to which the exclusions set forth in 24 CFR 5.609(c) apply. The following is a list of income sources that qualify for exclusion:

(i) The value of the allotment provided to an eligible household under the Food Stamp Act of 1977 (7 U.S.C. 2017(b));
(ii) Payments to Volunteers under the Domestic Volunteer Services Act of 1973 (42 U.S.C. 5044(f)(1), 5058);
(iii) Payments received under the Alaska Native Claims Settlement Act (43U.S.C. 1626(c));
(iv) Income derived from certain sub-marginal land of the United States that is held in trust for certain Indian tribes (25 U.S.C. 459e);
(v) Payments or allowances made under the Department of Health and Human Services' Low-Income Home Energy Assistance Program (42 U.S.C. 8624(f));
(vi) Income derived from the disposition of funds to the Grand River Band of Ottawa Indians (Pub. L. 94–540, 90 Stat. 2503–04);
(vii) The first $2000 of per capita shares received from judgment funds awarded by the Indian Claims Commission or the U.S. Claims Court, the interests of individual Indians in trust or restricted lands, including the first $2000 per year of income received by individual Indians from funds derived from interests held in such trust or restricted lands (25 U.S.C. 1407–8);

(viii) Amounts of scholarships funded under Title IV of the Higher Education Act of 1965, including awards under Federal work-study programs or under the Bureau of Indian Affairs student assistance programs (20 U.S.C. 1087uu). The exception found in § 237 of Public Law 109–249 applies and requires that the amount of financial assistance in excess of tuition shall be considered income in accordance with the provisions codified at 24 CFR 5.609(b)(9), except for those persons with disabilities as defined by 42 U.S.C. 1437a(b)(3)(E) (Pub. L. 109– 247). This applies to Section 515 with project based Section 8 only;

(ix) Payments received from programs funded under Title V of the Older Americans Act of 1965 (42 U.S.C. 3056g);

(x) Payments received on or after January 1, 1989, from the Agent Orange Settlement Fund or any other fund established pursuant to the settlement in the In Re Agent Orange liability litigation, M.D.L. No. 381 (E.D.N.Y.) (Pub. L. 101–201 and 101–39);

(xi) Payments received under the Maine Indian Claims Settlement Act of 1980 (Public Law 96–420, 25 U.S.C. 1721) pursuant to 25 U.S.C. 1728(c);

(xii) The value of any child care provided or arranged (or any amount received as payment for such care or reimbursement for costs incurred for such care) under the Child Care and Development Block Grant Act of 1990 (42 U.S.C. 9858q);

(xiii) Earned income tax credit (EITC) refund payments received on or after January 1, 1991 (26 U.S.C. 32(l));

(xiv) Payments by the Indian Claims Commission to the Confederated Tribes and Bands of Yakima Indian Nation or the Apache Tribe of Mescalero Reservation (Pub. L. 95–433);

(xv) Allowances, earnings and payments to AmeriCorps participants under the National and Community Service Act of 1990 (42 U.S.C. 12637(d));

(xvi) Any amount of crime victim compensation (under the Victims of Crime Act) received through crime victim assistance (or payment or reimbursement of the cost of such assistance) as determined under the Victims of Crime Act because of the commission of a crime against the applicant under the Victims of Crime Act (42 U.S.C. 10602);

(xvii) Allowances, earnings and payments to individuals participating in programs under the Workforce Investment Act of 1998 (29 U.S.C. 2931);

(xviii) Any amount received under the School Lunch Act and the Child Nutrition Act of 1966 (42 U.S.C. 1780(b)), including reduced-price lunches and food under the Special Supplemental Food Program for Women, Infants, and Children (WIC);

(xix) Payments, funds or distributions authorized, established, or directed by the Seneca Nation Settlement Act of 1990 (25 U.S.C. 1774f(b));

(xx) Payments from any deferred Department of Veteran's Affairs disability benefits that are received in a lump sum amount or in prospective monthly amounts as provided by an amendment to the definition of annual income in the U.S. Housing Act of 1937 (42 U.S.C. 1437) by Section 2608 of the Housing and Economic Recovery Act of 2008 (Pub. L. 110–289, 42 U.S.C. 4501). **This exclusion applies to Section 515 with project based Section 8 programs only**;

(xxi) Compensation received by or on behalf of a veteran for service-connected disability, death, dependency, or indemnity compensation as provided by an amendment by the Indian Veterans Housing Opportunity Act of 2010 (Pub. L. 111–269) to the definition of income applicable to programs authorized under the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4101) and administered by the Office of Native American Programs; and

(xxii) A lump sum or a periodic payment received by an individual Indian pursuant to the Class Action Settlement Agreement in the case entitled *Elouise Cobell et al.* v. *Ken Salazar et al.*, United States District Court, District of Columbia, as provided in the Claims Resolution Act of 2010 (Pub. L. 111–291).

(d) Annualization Of Income. If it is not feasible to anticipate a level of income over a 12-month period (*e.g.*, seasonal or cyclic income), or the PHA believes that past income is the best available indicator of expected future income, the PHA may annualize the income anticipated for a shorter period, subject to a redetermination at the end of the shorter period.

ATTACHMENT 6-B

ZERO INCOME VERIFICATION CHECKLIST

(A) EXPENSE	(B) RECURRING EXPENSE?	(C) PAYMENT SOURCE	(D) EXEMPT {If no, Col. E}	(E) AMOUNT
FOOD	☐Yes ☐No			
		Food Stamps		
		WIC		
		Food Bank		
		Cash Contributions	☐Yes ☐No	
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
SHELTER COSTS				
Housing	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		Other	☐Yes ☐No	
Electricity	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		Other	☐Yes ☐No	
Gas	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		Other	☐Yes ☐No	
Water	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		Other	☐Yes ☐No	
CLEANING/GROOMING	☐Yes ☐No	In kind Donation	☐Yes ☐No	
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
TRANSPORTATION	☐Yes ☐No			
		In kind Donation	☐Yes ☐No	
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Automobile Payment	☐Yes ☐No			

(A) EXPENSE	(B) RECURRING EXPENSE?	(C) PAYMENT SOURCE	(D) EXEMPT {If no, Col. E}	(E) AMOUNT
		In kind Donation	☐Yes ☐No	
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Automobile Insurance	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Gas	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Automobile Maintenance	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
ENTERTAINMENT	☐Yes ☐No			
Cable/Satellite		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Video Rentals	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Sporting Events	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
Other Entertainment	☐Yes ☐No			
		Cash Contribution	☐Yes ☐No	
		Other	☐Yes ☐No	
CLOTHING EXPENSES				
Clothes/Shoes	☐Yes ☐No	Cash Contributions	☐Yes ☐No	
		In Kind Donations		
		Other	☐Yes ☐No	
Laundry	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	

(A) EXPENSE	(B) RECURRING EXPENSE?	(C) PAYMENT SOURCE	(D) EXEMPT {If no, Col. E}	(E) AMOUNT
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
COMMUNICATIONS				
Telephone	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
Cellular Telephone	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
Pager/Beeper	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
Internet	☐Yes ☐No			
		Cash Contributions	☐Yes ☐No	
		In Kind Donations	☐Yes ☐No	
		Other	☐Yes ☐No	
MEDICAL EXPENSES				
		Cash Contributions		
		Other		
MISCELLANEOUS EXPENSES				
Non-reimbursable Education	☐Yes ☐No		☐Yes ☐No	
Non-reimbursable Childcare	☐Yes ☐No		☐Yes ☐No	
Non-reimbursable Job Expenses	☐Yes ☐No		☐Yes ☐No	

Part II

(A) BENEFIT SOURCE	(B) ELIGIBLE {If yes, Col. C}	(C) APPLIED {If yes, Col. D}	(D) STATUS
SOCIAL SECURITY	☐Yes ☐No	☐Yes ☐No	
UNEMPLOYMENT	☐Yes ☐No	☐Yes ☐No	
HEALTH AND WELFARE	☐Yes ☐No	☐Yes ☐No	
VETERANS ADMINISTRATION	☐Yes ☐No	☐Yes ☐No	
OTHER	☐Yes ☐No	☐Yes ☐No	

Attach receipts, applications and other documentation to the completed checklist and retain in application or tenant file.

ATTACHMENT 6-C

Allowable Deductions

Allowable deductions or allowances are:

☐ $480 for each member of the family residing in the household (other than the tenant, co-tenant, member, or co-member or spouse of either, or foster children) who is under 18 years of age, or who is 18 years of age or older and is disabled, handicapped or a full-time student. The student must carry a subject load considered full-time by the educational institution attended. This deduction does not apply to an unborn child in the household.

☐ $400 for any elderly family.

☐ In the case of an elderly family, the total of actual medical and/or handicap assistance expenses paid in excess of 3 percent of annual income must first be deducted from handicap assistance any remainder then deducted from medical expenses.

☐ Total medical expense includes medical expenses not covered by insurance that the tenant or member anticipates incurring over the 12 months following the effective date of the certification, using past experience as a guide.

> Examples of medical expenses are dental expenses, prescription and non-prescription medicines, medical insurance premiums including Medicare, eyeglasses, hearing aids and batteries, medical related travel cost, the cost of attendant care including a live-in-resident assistant, monthly payments required on accumulated major medical bills including that portion of a household member's nursing home care paid from household income(s).

Note: Premiums paid for nursing home insurance are not an allowable deduction unless a household member is housed at a nursing home and that person’s income is included in the household income.)

☐ Handicap assistance includes reasonable attendant care and auxiliary apparatus expense described as follows for each member with handicaps of the family to the extent needed to enable any family member (including such member with handicaps) to be employed. That portion of attendant care attributable to specialized medical reasons (the portion attributable to companionship is not counted).

- Auxiliary apparatus including but not limited to wheelchairs, oxygen equipment, reading devices for the visually impaired, and the cost of equipment added to cars and vans to permit their use by the handicapped or disabled family member proportionate to the amount of use by such persons.

☐ In the case of any non-elderly family, total handicap assistance expense in excess of 3 percent of annual family income may be deducted:

- For any handicap assistance expense above that is anticipated to occur over the 12 months following the effective date of the certification, using past experience as a

guide, to the extent needed to enable any family member (including the handicapped or disabled family member) to be employed.

- The amount of deduction may not exceed the LESSER of the amount by which total expenses for handicap assistance exceed 3 percent of annual family income, or the amount of income received by adult members from such employment.

☐ The amounts paid by the family for the care of minors under 13 years of age may be deducted only to the extent such expenses are not reimbursed. In the case of families assisted by American Indian housing authorities, the amount will be the greater of child care expenses; or excessive travel expenses, the to exceed $25 per family per week. Deductions for these expenses are permitted only when such care is necessary to enable a family member to further his or her education or to be gainfully employed, including the gainful employment of the disabled or handicapped family member. When the deduction is to enable gainful employment the amount may not exceed the amount of income received from such employment. When the deduction is to facilitate further education, the amount must not exceed a sum reasonably expected to cover class time and travel time to and from classes. The tenant file must contain justifying documentation. (Child support payments made on behalf of a minor child who does not reside in the unit may not be deducted as a child care expense).

ATTACHMENT 6-D

FAMILY ASSETS

☐ Net family assets include cash on hand and the value of savings, certificates of deposit, and dollars in checking accounts reported as "cash on hand." It will be such amounts reported on the day of third party verification. This definition also includes:

- The net cash value of real property.
- The cash value of whole life insurance policies.
- Individual Retirement Accounts (IRAs).
- Market value of bonds or other forms of capital.
- Personal property held as investments, irrespective of location, minus debts against them, minus cost of converting such assets to cash. Examples of conversion costs are penalties for early withdrawal, broker/legal fees assessed to sell an asset, and real estate settlement costs for transactions.

☐ Net family assets also include the value of equity of any business or household assets disposed of by a member of the household for less than fair market value (including disposition in trust, but not in a foreclosure or bankruptcy sale) in excess of the consideration received therefrom during the 2 years preceding the effective date of certification/re-certification. In the case of a disposition as part of a divorce settlement, the disposition shall not be considered to be for less than fair market value if the household member received important consideration not measurable in dollar terms.

☐ Income from net family assets which is included in annual income is determined as follows:

- If net family assets equal $5,000 or less, annual income includes the actual income derived from the net family assets.
- If net family assets exceed $5,000, annual income includes the greater of:
- Actual income derived from all net family assets, or
- A percentage of the cash value of such assets based on the bank passbook annual savings rate.

☐ Net family assets exclude:

- Interests in Indian trust land.
- The value of necessary items of personal property such as furniture and automobiles(s), and the debts against them.
- The assets that are part of the business, trade, or farming operation in the case of any member of the household who is actively engaged in such operation.

- The value of a trust fund (i.e., for a minor or legally incompetent household member) that has been established and the trust is not revocable by, or under the control of, any member of the household, so long as the fund continues to be held in trust.
- A vehicle specially equipped for the handicapped.
- Face value of life insurance policies.
- A cooperative member's patronage capital in the housing cooperative unit in which the family resides.
- Prepaid funerary arrangements and expenses.
- Retirement funds not accessible for withdrawal by a household member.
- Assets legally owned but not accessible or that accrue income to someone else.
- Savings accounts of dependent minors when such accounts are under the minor's social security number.

ATTACHMENT 6-E
LEASE REQUIREMENTS

A. Lease Structure

- All leases must be in writing.
- Initial leases must cover a one-year period.
- If the tenant is not subject to occupancy termination according to 7 CFR 3560.158 and 7 CFR 3560.159, a renewal lease or lease extension addendum must cover a one-year period.
- In areas with a concentration of non-English speaking tenants, leases must be available to tenants in both English and the appropriate additional language.
- Leases must give address (es) to which to direct complaints.
- Leases must include statement terms and conditions for modifying the lease.

B. Required Lease Clauses

Leases for all multi-family housing must include a number of specific clauses as listed below:

- The requirement to move or pay an increased rent if household income increases above moderate income. (This clause does not apply to leases for persons who are elderly, disabled, or handicapped <u>and</u> living in a full-profit plan development.)
- The requirement that tenants move out of the project within <u>30 days</u> of being notified by the borrower that they are no longer eligible for occupancy unless the conditions cited in 7 CFR 3560.158(c) exist.
- The requirement that tenants notify borrowers regarding changes in income, citizenship, or number of persons living in the unit.
- The requirement for tenants to notify borrowers in a situation of extended tenant absences.
- The requirements for making restitution when a household receives benefits to which it is not entitled and a statement advising tenants that the submission of false information could result in the initiation of legal action by the Agency.
- The requirement that tenants agree to income certification.
- The requirement that the household's tenancy is subject to compliance with the terms of all applicable assistance programs covering the unit and/or project.
- The requirement that during acceleration and foreclosure proceedings:
  - ◊ The tenant contribution must remain as if interest credit and/or rental subsidy were still in place and available had acceleration not occurred; and
  - ◊ The terms of the lease will remain in effect until the date acceleration and/or foreclosure is resolved.

Leases for tenants who have a *Handbook Letter 201, Letter of Priority Entitlement (LOPE)* and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available.

Leases must contain an escalation clause permitting changes in basic/note rate rents before the lease expires. Changes must be approved by the Agency.

Leases must specify no escalation in tenant contribution due to loan prepayment or when rental assistance or interest credit is terminated due to the fault of management or the owner, or due to liquidation and acceleration of the note.

Leases must include statement that tenant's payment will not change if Federal subsidies paid to borrower on behalf of tenants are suspended or canceled, for the term of the lease.

Leases must include statement that the project is financed by the Agency and that the Agency has the right to further verify information provided by the applicant.

Leases must say that project is subject to:

- Title VI of the Civil Rights Act of 1964
- Title VIII of the Fair Housing Act
- Section 504 of the Rehabilitation Act of 1973
- The Age Discrimination Act of 1975
- The Americans with Disabilities Act

Leases must specify requirements (and exceptions) to move to the next available appropriately sized unit, if the unit becomes overcrowded, underused, or should the tenant no longer meet eligibility requirements.

Leases must include a provision that establishes when a guest will be considered a member of the household and be required to be added to the tenant certification.

Leases must include a provision that tenancy remains in place as long as the tenant's possessions remain in the apartment, even after tenant has left. This is the case until possessions are removed voluntarily or by legal means, subject to state and local law.

Leases for rental assistance units must include specific clauses. These clauses must be signed by the lessor and lessee, and specify:

- The tenant's gross monthly contribution, and under what circumstances it may change; and that
- The tenant contribution will not increase if rental assistance is terminated due to actions by borrowers.

For tenants living in Plan II interest credit units, leases must include a provision on gross monthly contribution.

All leases, including renewals, must include the following language:

> "It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, state, or Federal law) while in or on any part of this apartment complex or cooperative is an illegal act. It is further

understood that such action is a material lease violation. Such violations (hereinafter called 'drug violation[s]') may be evidenced upon the admission to or conviction of a drug violation. It is further understood that domestic violence will not be tolerated on Rural Housing properties, and that such action is a material lease violation. All perpetrators will be evicted, while the victim and other household occupants may remain in the unit in accordance with eligibility requirements.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation or domestic violence to vacate the leased unit permanently, within time frames set by the landlord, and not thereafter enter upon the landlord's premises or the lessee's unit without the landlord's prior consent as a condition for continued occupancy by members of the tenant household. The landlord may deny consent for entry unless the person agrees not to commit a drug violation or domestic violence in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation or domestic violence, or has completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation or domestic violence, agrees to not commit a drug violation or domestic violence in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation or domestic violence, completed a counseling or recovery program within time frames specified by the landlord as a condition for continued occupancy in the unit. Should a further drug violation or domestic violence be committed by any non-adult person occupying the unit, the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land, the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law."

For handicapped-accessible units occupied by those not needing its special features, a lease must discuss situations where management has made a temporary unit assignment, and specify who bears the cost of moving the tenant to another unit. Additionally, the lease clause must require the management to provide the tenant written notification when they must move within 30 days of notification from management that an eligible applicant with disabilities requires the unit.

The household in the unit with accessibility features will be required to move within 30 days of the housing project's receipt of a tenant application requiring accessibility features if another suitably sized unit without accessibility features is available in the project. If a suitably sized unit is not available in the project within 30 days, the tenant

may remain in the unit with accessibility features until the first available unit in the project becomes available and then must move within 30 days.

Prepayment is subject to restrictive-use covenants. If prepayment occurs, leases and renewals must be amended to include a clause specifying tenant protections.

C. Required Information

All leases must contain the following information and provisions:

- The name of the tenant, any co-tenants, and all members of the household residing in the unit.
- The identification of the unit.
- The amount and due date of monthly tenant contributions and late payment penalties.
- The utilities, services, and equipment to be provided for tenants.
- The tenant's utility payment responsibility.
- The certification process for determining tenant occupancy eligibility and contribution.
- The limitations of the tenant's right to use or occupancy of the dwelling.
- The tenant's responsibilities regarding maintenance and obligations if tenant fails to fulfill these responsibilities.
- The agreement of management to accept tenant payment regardless of other charges that the tenant owes, and management's agreement to seek legal remedy for collecting other charges accrued by the tenant.
- The maintenance responsibilities of management in buildings and common areas, according to state and local codes, Agency rules, and fair housing requirements.
- The responsibility of management at move-in and move-out to provide tenants with a written statement of the unit's condition, and provisions for tenant participation in inspection.
- The provision for periodic inspections by the borrower or management, and other circumstances under which management may enter the premises while a tenant is renting.
- The tenant's responsibility to notify management of an extended absence, as defined in the lease.
- The agreement that tenants may not sublet the property without management or Agency consent.
- The provision regarding transfer of the lease if the project is sold to an Agency-approved buyer.
- The procedures that must be followed by management and the tenant in giving notice required under terms of the lease.

- The good-cause circumstances under which management may terminate the lease and length of notice required.
- The disposition of the lease if the housing becomes uninhabitable due to fire or other disaster, including the borrower's rights to repair the building or terminate the lease.
- The procedures for resolution of tenant grievances consistent with the requirements of 7 CFR 3560.160.
- The terms under which a tenant may, for good cause, terminate a lease with 30 days' notice prior to lease expiration.
- The signature clause indicating that the lease has been executed by the borrower and the tenant.

D. Projects and Units Receiving HUD Assistance

In multi-family projects receiving project-based assistance under Section 8 of the Housing Act of 1937, borrowers may use the HUD model lease. The provisions of the HUD model lease will prevail, unless they conflict with Agency lease requirements in accordance with this section. If there is conflict between HUD requirements and Agency requirements, the provision that will be enforced will be the one that is most favorable to the tenant.

A clause must be inserted into the lease requiring that tenants ineligible at recertification must leave the property unless allowed to stay under their HUD lease.

For HUD Section 8 certificate and voucher holders, borrowers may use:

- A standard HUD-approved lease;
- A HUD-approved lease that includes a number of modifications; or
- An Agency-approved lease if acceptable to HUD or the local housing authority.

E. State and Local Requirements

Borrowers must use a lease that is consistent with state and local requirements.

- If any lease provision is in violation of state or local law, the lease may be modified to the extent needed to comply with the law, but any changes must be consistent, to the greatest extent possible, with the required provisions established in 7 CFR 3560.156(c).
- Leases must include procedure for handling tenant's abandoned property, as provided by state law.

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ATTACHMENT 6-F

PROHIBITED LEASE CLAUSES

Borrowers are prohibited from including any of the following clauses in the lease:

- Clauses prohibiting families with children under 18.
- Clauses prohibiting occupancy by a handicapped person willing and able to modify the unit at their own expense.
- Clauses requiring prior consent by tenant to any lawsuit that borrowers may bring against the tenant in connection with the lease.
- Clauses authorizing borrowers to hold any of a tenant's property until the tenant fulfills an obligation.
- Clauses in which tenants agree not to hold borrowers liable for anything they may do or fail to do.
- Clauses in which tenants agree that borrowers may bring suit against the tenant without notice.
- Clauses in which tenants agree that borrowers may evict the tenant or sell their possessions whenever they determine that a breach or default has occurred.
- Clauses authorizing the borrower's attorney to appear in court on behalf of the tenant, and to waive their right to a trial by jury.
- Clauses authorizing the borrower's attorney to waive the tenant's right to appeal or to file suit.
- Clauses requiring the tenant to agree to pay legal fees and court costs whenever the borrower takes action against the tenant, even though court may find in favor of the tenant.

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ATTACHMENT 6-G

ACQUIRING AUTOMATION SUPPORT FOR MINC OR OTHER AUTOMATION NEEDS

The Agency will approve the use of project funds to acquire automated support to participate in MINC. While operating costs will be reduced in the long term, there may be some short-term increases to accommodate the initial acquisition of automated support.

Guidelines for obtaining automated support for MINC are as follows:

- With prior Agency approval, borrowers may use project operating or reserve funds to purchase or lease hardware or software needed to participate in MINC.
- Once borrowers have acquired automation capabilities, they may allow their management agent to use them to participate in MINC. This cost may be prorated over several projects owned by different borrower entities with a common management agent.
- When the cost of acquiring management software or hardware is not cost effective for a project (or multiple projects with common management), the Agency may allow the cost of contracting with a service bureau to provide automation support as a project operating expense.
- To request Agency approval, borrowers must submit a brief proposal that documents the anticipated costs and benefits of adopting the automation strategy being proposed.

1. Acquiring Additional Automation Capabilities

It is important to note that the approval for the use of project funds discussed above extends only to the portion of the computer software and hardware needed to participate in MINC. If additional software or hardware capacity is desired by the borrower, the following applies:

MFH borrowers are encouraged to use automated systems to manage MFH projects and to prepare and process paperwork associated with project management. Where economically feasible, computer applications can improve management efficiency and reduce errors and omissions. However, the purchase of computer hardware and software out of project funds should be carefully analyzed.

If a borrower entity's purchase of computer hardware or software to be used solely at a project can be expected to show a reduction in project operating and maintenance expenses, the purchase cost may be approved by the Agency as a line item project expense. The expense may be approved at project inception out of the project's two percent initial operating account or subsequent to project start-up out of annual operating revenues. The cost may be prorated over several projects owned by the same borrower entity. Any computer hardware or software purchased with project funds must remain with the project if there is any subsequent change in management or ownership of the project.

The purchase or use of computer hardware or software by a management company, versus a borrower entity with or without an identity of interest with a borrower, may not be considered an allowable line item expense on an Agency approved project budget.

2. Choosing to Use a Service Bureau

If acquiring automation is not a sound decision, borrowers may consider using a service bureau to provide automation services at a fee. The fee can be a project expense and should be reasonable. The Agency must approve a borrower's determination that it is in the best interest of the project to contract with a service bureau.

The cost of a service bureau is essentially an "add-on expense" to an operating budget, since the function is not currently performed by any project. Borrowers who find that their project budget will not support the cost of acquiring automation support or a service bureau fee should contact their servicing office to be exempted from mandatory participation in MINC.

The Agency will not allow an add-on fee for the cost of a service bureau if the borrower's analysis demonstrates that it is less expensive to acquire an automation capacity, unless extenuating circumstances exist.

The Agency will not approve the use of an add-on service bureau fee as a project expenses for a contract with a firm that has an Identify-of-Interest (IOI) with the project borrower or management agent, without detailed documentation indicating that the IOI service bureau is clearly more cost effective than a non-IOI service bureau. While this policy does not restrict the formation of IOI firms to process tenant certifications, service bureau companies or the payment for their services from a management fee, it is intended to address concerns expressed by the Office of the Inspector General (OIG) that IOI firms may unnecessarily inflate project operating expenses.

The following individuals and companies have expressed an interest in developing or marketing software to provide an industry interface with Rural Development's housing programs Multiple Family Housing tenant files, or providing automated support through a service bureau to transmit tenant certifications to the Agency. Rural Development expresses no preference or opinion on the products or services of any of the individuals and companies listed below.

LISTING OF PRIVATE SOFTWARE DEVELOPERS AND VENDERS WHO HAVE INDICATED AN INTEREST IN THE MANAGEMENT AGENT INTERACTIVE NETWORK CONNECTION (MINC) VOLUNTARY FIELD TEST

(Updated as of March 2004)

(Service Bureau) Accounting & Management Brenda Simpson P.O. Box 5058 Topeka, KS 66605 785-862-2068 785-862-1441 – fax brenda@bls_accounting.biz	(Service Bureau & Consulting) C&L Consulting Charles J. Kraebal, COS Laura D. Palmer, AHM 4253 Cactus Circle Liverpool, NY 13090 315-652-7100 315-652-7106 –fax cl@twcny.rr.com	(Service Bureau) Costello Property Management Corina Bittner P.O. Box 2238 Sioux Falls, SD 57101 605-336-9131 605-336-0527 – fax cbittner@costelloco.com www.costelloco.com
(Service Bureau) EPS, Inc. Fred Hutchins 18 Blair Park, Suite 208 Williston, VT 05495 802-872-0818 802-872-0820 – fax FHUTCH056@aol.com	(Service Bureau) KUSTOM BOOKKEEPING Ardith Scammehorn 1007 North Elm P.O. Box 217 Healy, KS 67850 620-398-2500 620-398-2501 – fax scamm@st-tel.net	(Service Bureau) RDC Data Processing Center Oleva Riney P.O. Box 238 326 E. Jefferson Memphis, MO 63555 660-465-7281 – voice 660-465-7163 – fax 660-465-2442 – tdd
Ausmus and Associates, Inc. Sam Ausmus III 3335 Federal Road Pasadena, TX 77504-1737 800-944-5572, ext. 201 713-944-2554 – fax sausmus.iii@ipm-software.net	Bostonpost Technology, Inc. Janet Wittenberg Dean Nicholdaides 436B S. River Rd. Bedford, NH 03110 603-669-8553 ext. 223 603-663-0085 – fax janet@bostonpost.com deann@bostonpost.com	BP Software Bennet and Ron Barlean 708 Nooksack Ave. Nooksack, WA 98276 360-966-5705 800-344-7611 360-966-3125 – fax bpsoftware@alphahunt.com www.bpsoftware.com
CAMS of Atlanta, Inc. Paul Angelich President 3340 Peachtree Road, NE Suite 1800 Atlanta, GA 30326 800-544-7569 404-814-5299 – fax Camsatl@Sprynet.com	Clancy Knaup 1333 Wayland Street P.O. Box 901 Beaver Dam, WI 53916 cbknaup@internetwis.com	Classic Real Estate Systems Mitch Copman 400 Pinnacle Way, Suite 420 Norcross, GA 30071-3661 770-729-0007 770-729-0065 – fax mitchc@classicresystems.com classic@classicresystems.com www.classicresystems.com
David Stathis Consulting David Stathis 315-247-1027	Dorsettt Computer Services Cleve Dorsett 806-793-9359 806-793-7510 – fax admin@dorsett.net	Fresno Housing Authority Bob Friesen 559-457-4130 559-457-4149 – fax rfriesen@pcabell.net Michael Powers 559-443-8463 559-443-8495 – fax mpowers@hafresno.org

High Tech Solutions Maurice King 1509 6th Street Marysville, WA 98270 360-653-1570 360-653-1722 – fax maurice@hightechsolutions.com	HUD Billing Joe Reeves 33616 25th Ave. Court South Roy, WA 98580 800-925-2276 253-843-0289 angelacres@foxinternet.net	IPM Software, Inc. 4008-C Vista Road, Suite 250 Pasadena, TX 77504 RHS Control 800-944-5572 ext. 212 info@ipm-software.net www.ipm-software.net
IPM-Software Jed Graef P.O. Box 880 Shelbume, VT 05482 802-985-2029 802-985-2668 – fax jgraef@worldnet.att.net	JF Gray Dusty Culler Farmington, NM 505-325-6515, ext 27 505-325-4305 – fax dusty@jlgray.com	Lindsey & Company Inc. Colleen Caldwell 2302 Llama Drive Searcy, AR 72143 501-268-5324 501-268-1198 – fax ccaldwel@lindseysoftware.com www.lindseysoftware.com
Millennium Software Valerie Gatson 1503 Goodwin Road Ruston, LA 71270 318-251-2392 318-255-7397 – fax support@millennium-software.com	MultiSite Systems, LLC Brent Lawrence 404 Thornwood Drive Jamestown, NC 27282 336-454-0147 336-454-5096 – fax brentl@multisitesystems.com	Pacific Cost Computer Services William Antoucci 916-348-7051
PMAS, IIC Frank Patterson 164 Rollins Ave., 2nd Floor Rockville, MD 20852-4038 301-770-2600 301-770-6508 – fax sfp@pmas.com info@pmas.com	PSL Consultants Steve Lang P.O. Box 241516 Memphis, TN 38124-1516 901-681-9831 901-763-2588 – fax slang@pslmgmt.com patlang@pslmgmt.com www.pslmgmt.com	Real Page Inc. 4000 International Parkway Carrollton, TX 75007-1913 1-87REALPAGE 972-820-3383 – fax 972-820-3137 – Scott Nelson scott.nelson@realpage.com 972-820-3383 – Susan Sloan susan.sloan@realpage.com 972-820-3354 – Janel Ganim janel.ganim@realpage.com
Shreve Group John Veach 1622 Taylor Ave. Washington, DC 202-882-6306 301-562-3006 ShreveGroup@msn.com Veachiii@aol.com	Simply Computer Software, Inc. Duane D. Tinsley, President 7310 N Alpine Rd. Loves Park, IL 61111 800-626-2431, ext #3 815-231-0065 – fax DuSCS@aol.com www.SimplyComputer.net	TCG Technologies LLC Gustavo Sapiurka 1012 N Street, NW Washington, DC 20001 800-226-999 202-667-3002, ext 390 202-667-3035 – fax sapiurka@tcgtechnologies.com Doug Stastny - 678-213-2805 d.stastny@cam-systems.com Anne O'Dell – 845-692-3048 a.odell@cam-systems.com www.tcgtechnologies.com
Tenmast Software James Mauch, President 132 Venture Court, Suite 1 Lexington, KY 40511 859-455-8061 856-367-7480 – fax jbatts@tenmast.com Markl@tenmast.com	Williams Mgmt & Consulting Bryan Porter P.O. Box 40 Blue Springs, MO 64015 816-220-0070 816-220-9164 – fax bryan@tenantcert.com	Yardi Systems, Inc. David Kessler 819 Reddick Avenue Santa Barbara, CA 93103 805-966-3373 ext. 227 1-800-947-2233 805-963-3155 – fax dave.kessler@yardi.com www.yardi.com

ATTACHMENT 6-H

FEDERAL REGIONAL INCOME LIMITS FOR HIRED FARMWORKERS

Region I—($7,200) Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont.

Region II—($5,400) New Jersey and New York. (Includes Puerto Rico and the USVI).)

Region III—($6,000) Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, and West Virginia.

Region IV—($6,150) Alabama, Florida, Georgia, Kentucky, Mississippi, North Carolina, South Carolina, and Tennessee.

Region V—($6,300) Illinois, Indiana, Michigan, Minnesota, Ohio, and Wisconsin.

Region VI—($6,900) Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

Region VII—($7,200) Iowa, Kansas, Missouri, and Nebraska.

Region VIII—($7,350) Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming.

Region IX—($8,850) Arizona, California, Hawaii, and Nevada.

Region X—($7,050) Alaska, Idaho, Oregon, and Washington.

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ATTACHMENT 6-I

ELIGIBILITY, INCOME, AND DEDUCTION CHECKLIST

Head of household and/or the co-head should complete.

LIST ALL HOUSEHOLD MEMBERS:

Name (Last, First, M.I.)	**Relationship**	**Date of Birth**	**Sex**	**Social Security #**
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____
_____	_____	___/___/___	___	_____

ELIGIBILITY:	**YES**	**NO**
1. I have a household member who is absent from the home due to:		
Employment		
Military service		
Placement in foster care		
Temporarily in nursing home or hospital		
Permanently confined to nursing home		
Away at school		
Other		
2. I have a live-in attendant		
3. Expected changes in household:		
Baby due on _____		
Adopting a child(ren) on _____		
Obtaining custody of a child(ren) on _____		
Obtaining joint custody of a child(ren) on _____		
Receiving a foster child(ren) on _____		

INCOME, ASSET, AND DEDUCTIONS

A. Income:	**YES**	**NO**
1. Are you or any other members of the household currently receiving income from any of the following sources?		
Wages/salaries		
Wages earned through a government program such as Senior Aides, Older American Community Service Employment Program, AmeriCorps If yes, which program:_____		
Tips, bonuses, or commissions		
Overtime pay		
Income from operation of a business		
Social Security		
Disability / SSI		
Death Benefits		
Pension / retirement funds		
Annuities or non-revocable trust		
Unemployment		
Military pay		
Workman's Compensation		
Public assistance / TANF		
Alimony		
Child Support		
Income from rent or sale of property		
Periodic payment from lottery winnings		
Regular recurring contributions from persons or agencies outside of household		
Insurance policies		
Severance pay		
Other		
2. Are there any adult members of the household (18 years of age or older) receiving income not listed above? If yes, specify the source of the income_____		

B. Assets:	**YES**	**NO**
1. Do you or any other members of the household have any of		
The following:		
Checking accounts – average balance last 6 months		
Savings accounts –current balance		
Certificates of deposit		
Money market funds		
IRA/Keogh account		
Stocks		
Bonds		
Treasury bills		
Trust funds (do you have access to the funds?)		
If yes, is the trust irrevocable?		
Real estate		
Whole life or universal life insurance policy (term not included)		
Cash held in safety deposit boxes or home		
Assets held in another state or foreign country		
Other		
2. Have you or any other members of the household received any		
lump sum payments, such as:		
Inheritance		
Lottery winnings		
Insurance settlements		
Other		
3. Have you or any other household members disposed of any asset(s) for less than fair market value in the past two (2) years?		
4. Do you or any other household members have any assets that are held jointly with another person?		

C. Deductions:	**YES**	**NO**
1. Are there any fulltime students 18 years of age or older in the household?		
2. Does any household member qualify for elderly deduction (age 62 or older or a person with disabilities)?		
3. Do you have medical expenses that are not paid for by an outside source such as insurance (applicable to elderly/disabled)?		
4. Do you have disability expenses that are not paid for by an outside source?		
If yes, is this service necessary to enable a household member (including the member with a disability) to be employed?		
5. Do you have attendant care expenses?		
If yes, is this service necessary to enable a household member (including the member with a disability) to be employed?		
6. Do you currently pay for childcare services for any children under the age of 13 residing in your household?		
If yes, is this service necessary in order for you to be employed or to attend school?		
If yes, are any of these expenses reimbursed by an outside source?		

ATTACHMENT 6-J

Required Tenant File Documentation

Tenant file records are critical pieces of source documentation, perhaps *the* critical source documentation, used as evidence to support determinations and conclusions in all areas of occupancy monitoring. The tenant file records must be complete and contain all information and forms relevant to occupancy at the project. The tenant files must be retained for at least 3 years or until the next Agency Supervisory Visit, whichever is longer. At a minimum the files should include:

I. Application/Household Information

A. Application (signed, dated, and date stamped);
B. Verification/certification of social security numbers, if available;
C. Citizenship declaration/immigration status (all household members) FARM LABOR ONLY;
D. Eligibility verification documents (e.g., person with disabilities, elderly, resident assistant, assistance animal, etc.);
E. Release and consent form for income verification for each adult household member; and
F. Acknowledgement of the head of household's receipt of lead based paint disclosure brochure, if applicable.

II. Lease

A. Lease (signed and dated);
B. Lease amendments/addendums/agreements;
C. Project rules and regulations;
D. Pet rules and pet deposit receipt, if applicable;
E. Security deposit receipt, if applicable;
F. Move-in inspection report;
G. Annual inspection reports; and
H. Lead-based paint addendum, if applicable.

III. Certification/Recertification

A. Initial and annual recertifications;
B. Recertification notices (initial and, if applicable, first, second, and third);
C. Verifications for income, assets, and deductions;
D. Disposal of assets verification (head of household, spouse, co-head);
E. Payment plans, if applicable;
F. Correspondence either issued to, or received from, tenant(s); and
G. Copy of Certified Mail Receipt.

IV. Other Files That Need to Be Maintained

A. Move-out files.

The current tenant file will become the move-out file. In addition to the above items, the move-out files must contain:

1. Copy of the intent to vacate notice received from the tenant;
2. Move-out inspection report;
3. Copy of the security deposit disposition notice provided to the tenant; and
4. Documents supporting retaining all or a portion of the security deposit.

B. Application/Reject Files.

1. Application;
2. Documentation to support the reason(s) for rejecting, such as screening information from previous landlords, personal references, credit reports, criminal activity, and refusal to sign consent form;
3. Copy of the written notice of rejection sent to the applicant; and
4. Any information or letters regarding appeals by applicants.

CHAPTER 7: RENTS, SHELTER COST, AND UTILITY ALLOWANCES

7.1 INTRODUCTION

The purpose of the low interest rate loans that the Agency makes is to enable borrowers to set rents at rates that are affordable to low- and moderate-income tenants, the target occupants for Agency-financed multi-family housing. Rents provide the necessary income stream to maintain and operate the housing. Thus, the Agency has a twofold interest in maintaining the rent streams in multi-family housing to protect the value of the property at affordable rates.

This chapter presents the program rules regarding rents, occupancy charges, and utility allowances for multi-family housing projects and the Agency's procedures for determining borrower compliance, including those for Farm Labor Housing projects. After reading this chapter, the Loan Servicer will understand the various types of project rents and how they are set, how rents are to be paid by tenants and collected and reported on by the borrower, and the procedure for changing rents in a project. They will also learn how security deposits are set and when they may be collected.

The Agency defines "rent" as the amount established as a charge for occupancy in a rental unit of Agency-financed multi-family housing. Rents must be established at the same rate for all similar units in the housing project: basic or note rent plus the utility allowance (when used) or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

Unless otherwise noted, for purposes of this discussion the term "rents" refers to both rents and occupancy charge, and "tenants" refers to both tenant and members of a cooperative.

SECTION 1: RENT REQUIREMENTS

7.2 RENT REQUIREMENTS BY PROJECT TYPE *[7 CFR 3560.202]*

A. Major Rent Levels

Subject to Agency approval, borrowers set project rents and utility allowances based on debt service and reasonable operating and maintenance expenses. Projects will have one or more of the following four rents:

- **Note rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in *Form RD 3560-52, Promissory Note.*

- **Basic rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in *Form RD 3560-52* reduced by the interest credit agreement.

- **U.S. Department of Housing and Urban Development (HUD) contract rent** is the rental charge established for housing receiving project-based HUD Section 8 rental subsidies in accordance with 24 CFR Part 880 or Part 884, as applicable.

- **Low-income housing tax credit (LIHTC) rent** is the rental charge established in accordance with LIHTC requirements.

B. Rent Levels by Project Type

These rent levels will apply depending upon the project type as follows:

- Plan I projects, direct and full-profit projects with loans made prior to 1968, and unrestricted Farm Labor Housing projects all have rents that are note rate only. Tenants all pay the same rent depending upon the size of their unit.

- Plan II projects have a minimum rent that is the basic rent and a ceiling rent that is the note rate rent. Tenants without rental subsidies (see Chapter 8, Rental Subsidies, for details) pay a rent within that range, based on their incomes. Tenants with rental assistance pay the basic rent, although the rental subsidy may pay all or a portion of the rent on behalf of the tenant.

- HUD Section 8 projects with interest credit have a minimum basic rent, a maximum note rate rent, and a HUD rent.

- HUD Section 8 projects without interest credit have a note rate rent and a HUD rent.

Exhibit 7-1 summarizes the rents that appear in each project type.

Exhibit 7-1

Rents by Project Type

Project Type	Rents
Plan I projects	Note rent
Plan II projects	Note, basic
Section 8/515 projects without interest credit	Note rent, HUD contract rent
Section 8/515 projects with interest credit	Note rent, basic rent, HUD contract rent
Early projects (pre-1968, direct loan and full profit projects)	Note rent
Labor housing—On Farm	No rent or note rent
Labor housing—Off Farm	Note
Congregate housing/group homes	Note rent, basic rent
Cooperatives	Note rent, basic rent

C. Setting Rent Levels

Rents are set by unit size and established by the borrower through a project budget at levels adequate to cover debt service, reasonable project operating expenses, and a return to owner if appropriate. Initial rents and any changes must be approved by the Field Office as part of the project budget approval process. Chapter 4 addresses procedures for determining whether project budgets are reasonable.

7.3 UTILITY ALLOWANCES *[7 CFR 3560.202]*

When tenants pay some or all of their utility costs themselves, borrowers must establish a utility allowance to determine the amount tenants pay toward rent. The utility allowance is deducted from the total shelter cost calculated for the tenant, and the difference is paid by the tenant as rent. If the tenant is entitled to a utility reimbursement, management companies may issue a joint check payable to the tenant and utility company, if they choose to do so.

A. Setting Utility Allowances

The utility allowance is based on expected costs for utilities. Once established, the borrower must review the utility allowance annually. This is done in conjunction with the annual budget process. The borrower must submit *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* to the Field Office and follow the procedures described in Section 4 of this chapter.

B. Approving Utility Allowances

Field Office Staff must review the utility allowance documents submitted with the budget to make sure that the numbers being used are reasonable and comparable to other projects in the same market area. The Loan Servicer should check current rate schedules and known rate increases from such sources as suppliers of electric utility, natural gas utility, water and sewer service, fuel oil and bottle gas; public service commissions; real estate and property management firms; and state and local agencies, including public housing authorities. In addition, the Loan Servicer should check project budgets of any other Agency-funded projects in the area to see if utility allowances are similar. Chapter 4 provides further guidance on revising cost increase justifications.

C. Monitoring Utility Allowances

To make sure that borrowers are correctly applying utility allowances, servicing staff must check tenant leases during supervisory visits of projects where tenants pay their own utilities. These leases should reflect the current utility allowances as shown on the current approved budget for the project.

7.4 DETERMINING TENANT RENT PAYMENT *[7 CFR 3560.203]*

Tenants pay rents in an amount that depends on the project type, whether utilities are included in the rent, the tenant's income, and the availability of rental subsidy. *Form RD 3560-8, Tenant Certificate* is used to determine individual rents. Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in accordance with 7 CFR 3560.152.

A. Net Tenant Contribution

Form RD 3560-8 is used to calculate a tenant's rent based on their income. The net tenant contribution to rent must not exceed the highest of:

- Thirty percent of monthly adjusted income, with an adjustment for any utility allowances, or
- Ten percent of gross monthly income, with an adjustment for any utility allowances, or
- If the household is receiving payment for public assistance from a public agency, the portion of such payment which is specifically designated by that agency to meet the household's shelter costs, or
- The basic rent, unless Rural Housing Service (RHS) rental assistance is provided to the household.

For an example of how to calculate the net tenant contribution, refer to Exhibit 7-2.

Exhibit 7-2

Examples—Net Tenant Contribution

(Where Rental Assistance (RA) is Available)

Example 1: The basic rent for a one-bedroom unit at Beautiful Acres Apartments is $350 and the note rate rent is $450. Tenants at Beautiful Acres pay their utilities directly, so there is a utility allowance of $60. *Form RD 3560-8* for Joe Smith shows that he has an annual income of $12,000. Since he is elderly, he receives a $400 adjustment for elderly status, giving him an adjusted annual income of $11,600. In completing *Form RD 3560-8*, the site manager calculates that 30 percent of Mr. Smith's adjusted monthly income is $290 and 10 percent of his gross monthly income is $100. Since he is receiving no payment for public assistance, the site manager enters $290 on line 30 (which is the highest of 30 percent of adjusted income, or 10 percent of monthly gross income, or the public assistance payment) of *Form RD 3560-8* as the Gross Tenant Contribution. The utility allowance must then be deducted, leaving a unit rent payment by Mr. Smith of $230.

Basic Rent	$350
Note Rate Rent	$450
Utility Allowance	$60
Mr. Smith's Annual Income	$12,000
Adjustment for Elderly Status	$400
Adjusted Annual Income	$11,600
30 Percent Adjusted Monthly Income	$290
10 Percent Gross Annual Income	$100
Payment for Public Assistance	$0
Highest of Above	$290
Deduction for Utility Allowance	$60
Unit Rent Payment for Mr. Smith	$230

Example 2: Joe Smith has decided to move to Cozy Home Apartments. The rents there include utilities. The basic rent for a one-bedroom unit for which he qualifies is $360 and the note rate rent is $460. His income information is the same, which means $290 is again entered onto line 30, Gross Tenant Contribution, of *Form RD 3560-8*. Since there is no utility allowance, Mr. Smith will make a unit rent payment of $290.

Basic Rent	$360
Note Rate Rent	$460
Utility Allowance	$0
Mr. Smith's Annual Income	$12,000
Adjustment for Elderly Status	$400
Adjusted Annual Income	$11,600
30 Percent Adjusted Monthly Income	$290
10 Percent Gross Monthly Income	$100
Payment for Public Assistance	$0
Highest of Above	$290
Deduction for Utility Allowance	$0
Unit Rent payment for Mr. Smith	$290

B. Unit Rents

1. Note Rents

In projects with note rents only, tenants will pay the note rent, regardless of income, unless they are income ineligible, in which case they will pay a surcharge.

When a Plan II project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a Special Note Rent (SNR) to attract or retain tenants whose income level would require them to pay note rent. An SNR is less than the note rent but is higher than the basic rent. The requirements for requesting and receiving an SNR are established under 7 CFR 3560.454.

2. Basic Rents

In projects with basic and note rents, tenants will pay their net tenant contribution, but no less than the basic rent and no more than the note rent.

3. Rental Assistance Rents

Tenants who are eligible to receive available rental assistance in a project pay the net tenant contribution. Rental assistance makes up the difference between the net tenant contribution and approved shelter costs (basic rent). Chapter 8 provides further details on charging and collecting rents from tenants with rental assistance.

4. HUD Section 8/USDA Section 515 Rents

In projects with HUD Section 8 housing assistance contracts, HUD sets the rents and utility allowances and tenants pay the borrower rent the total tenant payment (TTP), which is the greater of: 30 percent of monthly adjusted income or 10 percent of gross income; welfare rent or; $25. The HUD rent should never be less than the basic rent. If it is, the borrower must make up the difference, since it cannot be collected from the tenant.

5. Tenant-Based Subsidies

Tenants with tenant-based subsidies such as HUD vouchers pay the rents established at the project. If the voucher is less than the project rent, the tenant is responsible for the difference.

C. Overage

Overage is that portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal

Example

Jimmy Smits pays $180 a month in rent, which is 30 percent of his adjusted monthly income. The basic rent is $150. The $30 difference between the basic rent and Mr. Smits's rent payment is called overage.

to the difference between the note rent for a unit and the basic rent.

D. Unit Rents for Ineligible Tenants

There will be times when ineligible tenants occupy multi-family housing units. Such tenants must pay rent based on the type of project they occupy.

1. Surcharge for Ineligible Tenants in Plan I Projects

Ineligible tenants occupying a Plan I project must pay the established note rate rent plus a rent surcharge of 25 percent of the established rent. A Plan I project is defined in 7 CFR 3560.11.

2. Income-Ineligible Tenants in Plan II Projects

Income-ineligible tenants occupying Plan II projects must pay the note rate rent. A Plan II project is defined in 7 CFR 3560.11.

E. Unit Rents for Site Managers, Caretakers, and Owner-Occupied Units

When used as a revenue producing unit at approved rental rates, the salary paid to the site manager and/or caretaker will be included in the project operation and maintenance expenses. The same amount will be included in the annual income of the site manager and/or caretaker. The site manager and/or caretaker may be an eligible or ineligible tenant and their rent contribution will be based on their total income from all sources as shown on the tenant certification form.

When the unit is used as a non-revenue producing unit, the project cost of providing the unit will be treated the same as those of other non-revenue producing portions of the project. Project rental rates will be established as if the unit did not exist as living quarters. Debt payment will be as if the units were rented at basic rent. A tenant certification form will not be prepared for this situation.

With prior approval of the State Director, an owner may occupy a unit in the project when the owner will manage the project rather than hiring a management agent or site manager. If the unit is a revenue-producing unit, rental rates will apply to the borrower as they would to any other caretaker or manager.

F. Unit Rents for Low Income Housing Tax Credit Units

1. Setting and Collecting Rents

Unit rents in projects with LIHTCs will be set in accordance with regular Agency program rules. Two examples of setting such rents are provided in Exhibit 7-3. The Field Office must be aware that the LIHTC program prohibits owners from charging tenants more than a certain amount of rent in LIHTC units. Borrowers who do this risk recapture of their tax credits and stiff penalties. While the law does not allow the borrower to collect basic rent from the tenant if it exceeds the LIHTC limitation, overage

may be collected from the tenant in only those projects with 1991 and later tax credit allocations, if necessary, according to *Form RD 3560-8* even if that rent exceeds the LIHTC limitations.

Exhibit 7-3

Setting Unit Rents for Section 515 Projects with LIHTCs

Example 1: Assume the units receive only interest credit and no rental assistance or HUD Section 8 assistance. One-bedroom apartment: basic rent = $275, LIHTC rent = $250. The expense level required to meet financial requirements of the project exceeds the rent allowed to be charged by the low-income housing LIHTC program by $25.

Example 2: Assume a project where LIHTC rent is equal to or greater than the basic rent, and a previously eligible tenant's household income increases beyond the LIHTC rent. In this case, the tenant may or may not have previously received rental assistance or HUD Section 8. Example: One-bedroom apartment: basic rent = $250, LIHTC rent = $300. Only one co-tenant works. Household pays $200 per month and rental assistance is $50. Household is Agency and LIHTC eligible. Second co-tenant goes to work, causing the household rent to go up to $350. The new rent level exceeds both basic and LIHTC rents. Overage of $100 is due. LIHTC rent limitations require that the owner charge tenants no more than $300, which causes a shortage of $50 per month in overage due the Agency. Therefore, the owner is accountable for this shortage if the project was allocated LIHTCs prior to 1991. For projects allocated LIHTCs after 1990, the owner is allowed to collect the overage due from the tenants because gross rent that tenants pay in the LIHTC unit does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Agency under Section 515. The tenant cannot be required to move based on LIHTC ineligibility.

2. Agency Review and Monitoring of LIHTC Rents

The law does not excuse the borrower from paying the basic rents required to the Agency; these rents must be deposited into the operating account in full. Borrowers must be informed by Loan Servicers that the borrowers are responsible for funding any gap between basic rents and tax credit rents collected from tenants when basic rent exceeds LIHTC rents. This fact should be noted when the Loan Servicer reviews the project operating budget.

Borrowers must not use project funds to make up any difference between rents required under Agency program rules and the maximum allowed rents under the LIHTC program, and they must collect the required rents. During the annual review process, Loan Servicers should review the previous year's budget with a focus on any cash shortfalls. If the Loan Servicer determines that a shortfall exists due to differences between tax credit limitations and basic rents, they must ensure that a provision is made in the coming year's budget and future years on line 11, "Cash-non project" of *Form RD 3560-7* for the owner to contribute necessary funds to meet the required rents.

G. Adjustments to Unit Rents

Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in

accordance with 7 CFR 3560.152. Borrowers are not required to recertify a household prior to the annual recertification unless a change in household income of $100 or more per month occurs. If a tenant requests it, the borrower must recertify the tenant for a change in household income of $50 or more per month (see Chapter 6 for further details on interim recertifications).

A change in household status could take place in any one of the following circumstances:

- The tenant has had a change in income (increase or decrease);
- The tenant has had a change in the size of the household (increase or decrease in number of people residing in the unit); or
- The tenant has had a change in the type of household (the household may become handicapped or elderly, or a 17-year-old child may turn 18).

If *Form RD 3560-8* shows that a change in rents is in order as a result of the change in household status, the effective date of a tenant's changed rent is the first day of the month following third-party verification of the tenant's reported changes. However, the management agent must complete the verification process no later than 30 days following the tenant's notice of the change.

7.5 RENTS DURING EVICTION OR FAILURE TO RECERTIFY *[7 CFR 3560.208]*

Tenants must continue to pay rents during termination through eviction and if they are not recertified for occupancy.

A. Rents for Tenants Being Evicted

Tenants must continue to pay rents as per *Form RD 3560-8* while the eviction process is underway.

B. Rents for Tenants without a Current Certification

A tenant who is not recertified is technically an ineligible tenant, and note rate rent must be collected and deposited to the general operating account for that tenant. Whether the tenant or the borrower/management agent pays the note rate depends upon who is to blame for the failure to recertify.

1. Tenant Failure to Recertify

If a borrower can document that a tenant received a notice specifying a tenant recertification date, and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, will give the tenant and the Agency written notification that:

- Termination proceedings are being initiated, in accordance with 7 CFR 3560.159; and
- The tenant will be charged note rent until the tenant's lease is terminated.

2. Borrower Failure to Recertify

If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants will continue to make net tenant contributions to rent based on their most recent *Form RD 3560-8.* The borrower must remit to the Agency from non-project funds, full overage as if the tenant was paying the note rent until the tenant is re-certified.

7.6 IMPROPERLY ADVANCED RENTS *[7 CFR 3560.209]*

Improperly advanced interest credit or rental assistance, whether it was the fault of the borrower or the tenant, will be recaptured in accordance with the requirements established by 7 CFR part 3560, subpart O.

A. Borrower Error

When rents have been improperly collected from a tenant due to borrower error, such as a miscalculated *Form RD 3560-8* the borrower must make up the difference to the Agency for any additional rents that should have been collected or reimburse the tenant for any excess rents collected.

B. Tenant Fraud

When the borrower has collected an incorrect rent amount from the tenant due to tenant fraud, the borrower must make every attempt to recapture the rent due from the tenant. Once the borrower has delivered documentation to the Loan Servicer of failed attempts to collect, the Loan Servicer must comply with the requirements of 7 CFR part 3560, subpart O to pursue collection.

7.7 MONITORING TENANT CONTRIBUTION AND UNIT RENTS

A. Borrower Monthly Submissions

The Loan Servicer monitors unit rents and tenant contributions on a monthly basis via *Forms RD 3560-29* and *RD 3560-8*.

B. Site Visits

The Loan Servicer will verify information on *Forms RD 3560-29* and *RD 3560-8* during site visits through random tenant interviews. If the Loan Servicer is told by any tenant that they pay a different amount of rent than is shown on *Form RD 3560-29, Interest Credit and Rental Assistance Agreement,* for that tenant, the Loan Servicer must ask the borrower or management agent to explain the discrepancy.

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SECTION 2: SECURITY DEPOSITS

7.8 SECURITY DEPOSITS *[7 CFR 3560.204]*

Borrowers should collect security deposits as assurance of rental payment or charges for damages when it is reasonable and customary for the area in which the project is located. Security deposits are largely governed by state and local laws; Loan Servicers must familiarize themselves with those laws.

A. Allowable Amounts

The borrower must specify the amount of the security deposit that will be charged in a project by unit size in the management plan and in the dwelling lease. This amount may not be changed without prior consent of the Agency. The following requirements must be met:

- Borrowers may charge security deposits in an amount that is typical for the area, but the security deposit charged to a tenant may not exceed that tenant's contribution for one month's rent or the basic rent, whichever is greater;
- Households receiving a HUD rental subsidy must pay security deposits according to HUD requirements;
- Members in a cooperative must pay a membership fee equal to one month's occupancy charge; and
- Security deposits for tenants may not be increased in later years, even if the tenant has been residing in the project for a long time and the initial amount charged is not representative of current basic rents or security deposits.

B. Payment Plans

If tenants cannot pay the full amount of the security deposit initially, they may be placed on a payment plan. Should installments not be met, the total charge may become due and payable in full.

C. Authorized Uses

Funds in the security or membership fund account must only be used for authorized purposes as specified by the borrower's management plan.

Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts. An itemized accounting for any charges against the security deposit must be presented to the tenant after the move-out inspection, unless the tenant has abandoned the project and their whereabouts are unknown and cannot be ascertained after reasonable inquiry. Resolution of any security deposit disputes must be handled in accordance with state and local laws.

Any amount which is kept by the borrower as a result of lease or occupancy agreement violation must be transferred to the general operating account and treated as project income.

D. Accounting and Interest

Security deposits must be held in a separate bank account in a Federally insured institution in accordance with 7 CFR 3560.302 (see Chapter 3). These funds are held in trust for the tenant until used or returned to the tenant.

Any interest earned on security deposits will accrue in accordance with state law, but in no case will it accrue to the project management or the borrower. If a state requires the borrower to pay the interest earned on security deposits and the borrower collects more interest than is required by the state, the additional interest must be deposited into the general operating account for use by the project.

Any interest on security deposits unclaimed by a tenant must accrue to the project and must be deposited by the borrower into the general operating account.

E. Additional Deposits

Borrowers may charge additional deposits for pets; however, these must not exceed basic rent for the animal owner's unit. Where a service animal is necessary for the normal function of a household member, an additional security deposit must not be charged.

Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

7.9 MONITORING SECURITY DEPOSITS

Loan Servicing staff will monitor security deposits charged to and collected from tenants during supervisory visits by:

- Reviewing project annual financial statements;
- Reviewing dwelling leases and comparing the amount charged with what has been specified in the current management plan;
- Reviewing bank statements to see what the deposits of security deposits total; and

- Asking tenants to confirm what they have paid as security deposits.

Any discrepancies must be explained by the borrower or management agent. Monitoring of security deposit accounts is further addressed in Chapter 3.

SECTION 3: RENT COLLECTION

7.10 RENT COLLECTION *[7 CFR 3560.209]*

Borrowers must collect rent on a monthly basis. Rents should be due on the first day of the month. The time and place of onsite collection and/or the address for payment by mail should be well publicized and consideration should be given to an after-hours depository, if needed. Borrowers must maintain an accounting system to collect and track receipts that can be audited.

A. Tracking Rents

Any collection system employed by the borrower must include the following:

- A serially numbered receipt book or similar device to track collections;
- A ledger that shows which tenants have paid their rents and which have not; and
- If collections are held onsite, they must be secure. A safe may be used to ensure security.

The borrower must explain how the above requirements are to be met in the management plan. The Loan Servicer will verify that these requirements are being met during onsite supervisory visits by asking to see the receipt book or similar tracking device, the ledger, and the onsite collection device, if any.

B. Fees for Late Payments

Borrowers may adopt a late fee schedule for overdue rental payments. Late fee schedules must be submitted to the agency for approval as part of the housing project's management plan, be in accordance with state and local law, and consistent with the following requirements:

(1) A grace period of 10 days from the rental payment due date must be allowed for all tenants.

(2) The late fee must not exceed the higher of $10 or an amount equal to 5 percent of the tenant's gross tenant contribution.

(3) Tenants receiving housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

Any other type of schedule must be submitted by the borrower to the Agency for approval. All schedules must be in accordance with state and local laws and must be

justifiable. To approve the schedule, the Loan Servicer needs to make sure that the fees are not excessive, are customary for the area, and allow for a reasonable grace period.

The borrower must describe any late fee schedule in the management plan. During the onsite supervisory visit, the Loan Servicer must ask tenants about the late fees schedule to make sure it is as the borrower has described it. The Loan Servicer must also check leases to confirm that the late fee schedule is stated and matches its description in the most current management plan. Any discrepancies must be explained by the borrower.

7.11 BORROWER REPORTING OF RENTS

Borrowers must report to the Agency on *Form RD 3560-29, Notice of Payment Due Report* all rents, overages, and surcharges collected. This form shows the occupancy status of each unit, rents collected from each tenant, and borrower payment and agency tracking of overage. Overage is the amount by which total rental payments paid or to be paid by the tenants of a project exceed the total basic monthly charge (see paragraph 7.4). Borrowers identify any overage collected on *Form RD 3560-29*. Overage is returned by the borrower to the Agency. Overage for an account with an interest credit agreement is charged to the account as additional interest on the initial loan. Tenant contributions must be applied first to rental charges rather than to miscellaneous charges and fees, such as late fees.

A. Agency Tracking of Overage

The Loan Servicer must process overage that is reported and returned by the borrower with *Form RD 3560-29* through the use of MFIS. Overage is coded for Agency accounting purposes depending upon the type of project it is collected from as follows:

Overage Type 1: Occupancy surcharge paid by ineligible tenants in Plan I projects. Occupancy surcharge is equal to twenty-five percent (25%) of note rate rent.

Overage Type 2: Rents paid by tenants in a Section 8/515 Project with an Interest Credit Plan Code of 7 or 8 that are greater than the basic rent, up to the note rent.

Overage Type 3: Rents paid by tenants in a Plan II project that are in excess of the basic rent up to the note rate rent. This includes HUD contract rents in a Section 8/515 project with an Interest Credit Plan Code of 2 that are greater than the basic rent, up to the note rate rent.

Overage collected that is in excess of the note rate rent in Section 8/515 projects with interest credit, where the HUD contract rent exceeds note rate rent, is reported on *Form RD 3560-29* as excess Section 8 funds and is deposited into the project reserve account.

For additional information on how the Agency handles overage, please refer to the Automated Multi-Family Housing Accounting System (AMAS) manual.

B. Payment of Overage for Multi-Family Housing Projects with Interest Credit and No Rental Assistance

When 30 percent of a tenant's adjusted income exceeds the basic rent, the difference they pay in rent between the basic rent and the note rate rent is referred to as overage. This is returned by the borrower to the Agency as extra interest payment on the loan. Exhibit 7-4 provides an example of how overage is paid.

Exhibit 7-4 Example—Overage Payments at Sunny Brook			
Basic Rent: $350	Note Rate Rent: $400		Utility Allowance: $0
Tenant	30% of Adjusted Monthly Income	Rent Payment	Overage Payment
Smith	$200	$250	$0
Miller	$350	$350	$0
Jones	$375	$375	$25
Young	$400	$400	$50
Brown	$400	$400	$50

C. Payment of Overage for Section 8/515 Projects

It is Agency policy that any funds paid by HUD are paid on behalf of a tenant. Therefore, the Agency does not consider any HUD Section 8 payments as excess funds until any benefits provided by the interest credit agreement are recovered. Borrowers must collect overage for their tenants as follows:

1. For Section 8/515 Projects with a One Percent or Two Percent Reduced Interest Rate

In 100 percent Section 8/515 projects when the HUD contract rental rate is more than the one or two percent reduced interest rate and is either equal to or less than the note rate rent, overage will be paid to the Agency in an amount equal to the difference between the HUD contract rental rate and the 1 or 2 percent reduced interest rate. The overage is reported as Overage Type 2.

In 100 percent Section 8/515 projects when the HUD contract rental rate is greater than the note rate rent, the difference between the one or two percent reduced interest rate and the HUD contract rate will be paid to the Agency and reported as overage Type 2. The amount equal to the difference between the HUD contract rental rate and the Agency note rate rent will be deposited in the reserve account as excess income.

In 100 percent Section 8/515 projects when the HUD contract rental rate exceeds the note rate rent, the borrower must use *Form RD 3560-29* to document the required deposit in the reserve account.

Exhibits 7-5 and 7-6 provide examples of how overage is determined in Section 8/515 projects.

Exhibit 7-5 Determining Overage in Section 8/515 Projects With 1 or 2 Percent Reduced Interest Rate—Examples		
Example 1		
1 or 2 Percent Reduced Interest Rate	**HUD Contract Rent**	**Note Rate Rent**
$250	$300	$375
$50 difference paid to Agency as overage type 2		$75 interest credit
Example 2		
1 or 2 Percent Reduced Interest Rate	**Note Rate Rent**	**HUD Contract Rent**
$250	$375	$400
$125 difference paid to Agency as overage type 2		$25 required to be placed into reserve
Note: If the HUD contract rent and the Agency 1 or 2 percent reduced interest rent are the same, then the first column would not apply.		

2. For Section 8/515 Projects with Full Interest Credit

In Section 8/515 projects the overage is the difference between basic rental rate and the note rate rent including the income from HUD. The overage will be reported as Type 3.

In the cases where the HUD contract rental rate exceeds the note rate rent the difference is excess income and will be deposited in the reserve fund. The borrower should use *Form RD 3560-29*, Part I, items 23 through 29, to document the required deposit in the reserve account.

Exhibit 7-6

Determining Overage in Section 8/515 Projects With Interest Credit—Examples

Example 1

Basic Rent	HUD Contract Rent	Note Rate Rent
$175	$300	$375
$125 difference paid to Agency as overage type 3 by Section 8 tenants and subject to overage type 2 by non-Section 8 tenants		$75 interest credit and subject to overage Type 1 from non-Section 8 tenants

Example 2

Basic Rent	Note Rate Rent	HUD Contract Rent
$175	$375	$400
$200 difference paid to Agency as overage by Section 8 tenants and subject to type 2 overage by non-Section 8 tenants		$25 required to be placed in reserve account as excess income

SECTION 4: RENT CHANGES

7.12 OVERVIEW

All borrowers, including those using HUD Section 8 contract assistance, must obtain prior Agency approval for a rent increase. Changes in rental rates will apply to all units in a project. Rent change requests for multi-family housing projects with no HUD subsidy are typically submitted and reviewed at the same time the borrower submits their annual budget for approval. Rent changes in Section 8/515 projects resulting from rent increases by HUD must also be reviewed and must not automatically be approved. For any project, only the amount of rent necessary to cover project expenses must be approved. This section covers rent changes in projects without HUD subsidies, then changes in projects with HUD subsidies.

7.13 CHANGES IN RENTS AND UTILITY ALLOWANCES *[7 CFR 3560.205]*

It may be necessary as operating costs and/or revenues in a project fluctuate for the borrower to request Agency approval to effect a rent change. Exhibit 4-1 shows the timeline for borrower submission and Agency review of rent change requests. This process is also described in Chapter 4.

A. Rent Change Requests under Special Circumstances

The Loan Servicer may accept borrower requests for rent or utility allowance changes at times other than with the annual budget submission under special circumstances where a change is necessary to preserve the financial integrity of a project and the financial distress is due to circumstances beyond a borrower's control. Such circumstances might be in the event of a natural disaster or when work-out procedures are necessary.

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a special note rent (SNR), which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent. The requirements for receiving an SNR are established under 7 CFR 3560.454.

B. Annual Utility Allowance Reviews

The borrower should review utility allowances on an annual basis to determine whether any changes have to be made. The borrower should indicate no changes to utility rates in the comment section of the budget narrative.

C. Tenant Notification and Comments

At the same time the borrower submits the initial notice to the Agency that they intend to submit a rent change request, the borrower will send or deliver notices to each tenant in the project notifying them of the rent change request that will be submitted to the Agency with their annual budget. **Appendix 4** provides an example of such a notice.

The borrower must also post this notice in a common area frequented by the tenants, such as the laundry room or near the mailboxes.

The notice must notify tenants that they have 20 days to provide their comments to the Agency. If during this time the Agency receives any tenant comments, these must be immediately forwarded to the borrower, with the identity of the tenant protected. This can be done by either paraphrasing the comments for the borrower or by removing any identifying information from the correspondence received from the tenant and forwarding it on to the borrower.

After the 20-day comment period, the Agency must notify the borrower of approval or rejection within 10 days.

D. Documentation

The borrower must fully document any rent change request. Requests for a rental charge change must be based on a realistic projected budget for the interim year or the ensuing full year. The borrower must provide to the Agency the information identified in Exhibit 7-8 with the rent or utility allowance change request.

Exhibit 7-8

Information Required to Document Rent or Utility Allowance Change Request

1. *Form RD 3560-7* must be used to reflect the project's financial needs for the year and thereby rental charge requirements. A narrative cover letter must be included explaining why the rent change is necessary. A new operating budget for the fiscal year must show:
   - Currently approved budget at old rents;
   - Proposed budget at proposed new basic rents; and
   - Proposed budget at proposed new note rate rents (if applicable).
2. Actual utility costs. Refer to Chapter 4 for a description of the information required to document utility allowance change requests.
3. Additional documentation. Additional documentation must be attached to *Form RD 3560-7* in accordance with the instructions to these forms as evidence of the need for the rent or utility allowance change.
4. Other information. Any other information the borrower believes is necessary to justify the proposed shelter cost change.

The narrative attached to the budget form must clearly explain the necessity for the change request and the Loan Servicer must analyze the supporting documentation to the budget and *Form RD 3560-7* to see if it supports the request. For example, if the rent increase is due to increased taxes, then the Field Officer should look for copies of tax increase notices in the budget documentation. If the rent increase is due to an increase in general operating expenses, the Field Officer must review those expenses for reasonableness. Chapter 4 discusses reasonableness and how a budget should be reviewed for acceptability.

E. Agency Responsibility

1. Reviewing the Rent Change Request

When the borrower submits a budget with a rent or utility allowance change request, the Agency must respond to the borrower within 60 days. If the Agency does not contact the borrower, the borrower may assume that any rent change request of $25 or less has been automatically approved.

2. Circumstances in which the Agency Will Not Approve a Rent Increase

The Loan Servicer must not approve a rent increase under the following circumstances:

- The borrower is able but unwilling to comply with program requirements. Such a borrower has ignored repeated requests from the Loan Servicer to take servicing actions by a specified deadline.

- If the borrower is in default of the Agency loan agreement and does not have an Agency-approved work-out plan, or is not in compliance with an Agency-approved workout plan.

- There are sufficient project funds under the existing rents to meet project operating expenses, and the borrower is not able to justify the higher rents. Such a condition is established when the project budget shows that income meets expenses at current rent levels.

- The project is operated on a profit basis, and the rent change would result in rents higher than what tenants can afford. This condition is established by comparing rents with 30 percent of tenant adjusted incomes. If it is shown that tenants would be paying in excess of 30 percent of their adjusted incomes as new rents and the increase is not necessary to meet projected costs, then the increase must not be approved.

3. Rejection of Rent Change Request

If the Loan Servicer rejects the change request, the borrower must be notified and be provided with appeal rights.

4. Effective Dates of Change

The effective dates of any approved changes will coincide with the start of the project's fiscal year or the start of the season for labor housing projects. For an allowance increase request on which comments were solicited, the borrower must deliver a notice to tenants announcing the rent or utility allowance increase to be effective 30 calendar days from the date of the notification, unless the rent increase will be the same as what was stated in the initial notice to the tenants.

If the figure is revised downward, the borrower must notify the tenants of their new rents prior to the first day of the month in which the new rent amounts are due. However, the borrower does not have to give 30 days' notice of the new rents in this case.

For notices to tenants, see **Appendix 4**.

7.14 RENT CHANGES FOR UNITS RECEIVING HUD SECTION 8 ASSISTANCE *[7 CFR 3560.207]*

The Agency has the responsibility to review and approve project budgets on an annual basis based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer will not take into account HUD's automatic annual adjustment for Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.

A. Reviewing Budgets with HUD Subsidies

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have a three-column budget in properties with HUD Section 8 contracts. Exhibit 7-9 depicts how many columns are required in the budget, depending upon the project type.

Exhibit 7-9

Reviewing Budgets with HUD Subsidies

Project Type	Columns Needed in Budget
• 100 percent Section 8/515 with no interest credit; HUD contract rent rate is equal to basic rent • 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic rent and less than note rate rent • 100 percent Section 8/515 without interest credit; HUD contract rent is greater than note rate rent • Less than 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic and less than or greater than note rate rent	• One column only showing HUD contract rent • Three columns showing basic rent, HUD contract rent and Agency note rate rent • Two columns showing HUD contract rent and note rate rent; difference is excess funds and deposited into reserves • Three columns showing basic rent, HUD contract rent and Agency note rate rent

B. Excess Rents

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 7-9, the borrower must deposit the difference between the Agency approved note rate rent and the higher HUD-authorized rate into the reserve account. The manager or borrower must use *Form RD 3560-29* to document the required deposit in the reserve account.

If excess HUD rents accumulate in the reserve account beyond the sum shown in the borrower's loan agreement or resolution, the Loan Servicer may reduce or cancel the interest credit on the project. The Agency may reinstate interest credit whenever HUD rent should become lower than the Agency note rate rent.

Before depositing excess funds in the reserve account, the borrower may have to collect overage. Whether overage is collected and a project is subject to cancellation of interest credit depend upon the issuance date and execution date of the project's interest credit agreement.

Certain early versions of the interest credit agreement do not have a legal basis to support the Agency's policy to cancel interest credit or collect overage to offset interest credit. Each Section 8/515 project needs to be categorized according to the issuance date

and execution date of the project's interest credit agreement on *Form FHA 444-7* or its successor *Forms FmHA 444-7* and *RD 3560-9*. Exhibit 7-10 provides a description of the rules that apply to each interest agreement form.

Exhibit 7-10

Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account

Form	Executed Before October 27, 1980	Executed On Or After October 27, 1980
FHA 444-7, dated 11/17/69 and 7/27/72	No basis to cancel or reduce interest credit, collect overage, or deposit excess funds in the reserve account unless the borrower agrees.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 444-7, dated 10/13/77	• If first, second, fourth or fifth block of paragraph 2 checked, no legal basis to cancel or reduce interest credit, collect overage, or deposit excess funds into reserves. • If the third block of paragraph 2 is checked, no legal basis to cancel or reduce interest credit, unless borrower agrees. However, there is legal basis to collect overage and deposit excess funds to reserves and/or apply it on the loan.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 1944-7, dated 11/29/82		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.
FmHA 1944-7, dated 4/85		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.

SECTION 5: RENTS FOR LABOR HOUSING PROJECTS

7.15 OFF-FARM LABOR HOUSING

A. Rent Structure

Tenants in Off-Farm Labor Housing are required to make a monthly rent payment in the amount equal to:

- In units with rental assistance, 30 percent of their income for rent in accordance with the amount calculated annually on *Form RD 3560-8*; or
- The approved rent, when rental assistance is not available.

B. Establishing a Basic Rent at the Property

For each Off-Farm Labor Housing project, the Agency will establish a basic rent in accordance with the project's annual operating budget. This basic rent will be equal to the project's operating expenses, plus the debt service payment based on the project's one percent interest rate, as approved by the Agency.

7.16 ON-FARM LABOR HOUSING

Rents for On-Farm Labor Housing should be in accordance with the employment agreement between the tenant and the borrower. In general, rents should not be required for projects assisted through the On-Farm Labor Housing program. Borrowers who choose to charge rents at On-Farm Labor Housing properties must comply with the rent setting and adjustment procedures established for Section 515 projects in this chapter.

On-farm labor housing borrowers are not required to charge security deposits, but if they do so, they must follow the terms described in Section 2 of this chapter.

CHAPTER 8: RENTAL SUBSIDIES

8.1 INTRODUCTION

Rental subsidies are deep subsidies that enhance the affordability of rents in a project. Each year, the Agency has available a limited number of Agency-funded rental assistance units that can be allocated to new or existing Agency-financed multi-family housing projects. The Agency also encourages the use of non–Agency rental subsidies in multi-family housing projects as a way to reduce tenants' rents.

Because rental subsidies are limited, it is important that they be allocated to borrowers and distributed to tenants in a fair and equitable manner. Consequently, the Agency has developed rules that must be followed in the distribution and administration of rental subsidies. This chapter presents the program rules and procedures for allocating and administering rental subsidies in multi-family housing projects, including Farm Labor Housing projects. It covers not only Agency-funded rental assistance, but U.S. Department of Housing and Urban Development (HUD) and other types of subsidies as well.

For purposes of this chapter, the term "tenant" also means "member," and "rental assistance" is reserved for use in describing Agency-financed rental subsidy.

8.2 AUTHORIZED RENTAL SUBSIDIES *[7 CFR 3560.252]*

A. Project-Based Rental Subsidy

The Agency may authorize the use of project-based rental subsidies in addition to interest credit for multi-family housing projects. These rental subsidies may take the form of:

- **Agency-funded rental assistance.** This is a project-based subsidy program available to very low- and low-income tenants in Agency-financed multi-family housing.

- **HUD Section 8 assistance.** This project-based subsidy is administered by HUD and was used extensively with Agency-financed housing from the mid-1970s to the early 1980s.

- **Private rental subsidy.** This is a subsidy program whereby the project owner(s) or others enter into an agreement with the Agency to provide and fund subsidy to tenants of the project on approximately the same basis as the Agency-funded rental assistance program. In some instances, the agreement may include a limit on the number of units and a per-unit ceiling on the amount of assistance.

- **State or local rental subsidy.** Such subsidy is provided and funded by some states and available to borrowers to assist tenants on approximately the same basis as the Agency rental assistance program. The assistance is in the form of a contract between the borrower and the state and has the Agency's concurrence.

- **Operating subsidy for off-farm migrant farmworker projects.** Section 521 Agency rental assistance funds may be used as operating assistance in migrant farmworker projects financed under 514 or 516 to reduce operating costs so that rents may be set at rates affordable to low-income migrant farmworkers.

B. Tenant-Based Rental Subsidies

HUD Section 8 Vouchers may be accepted by borrowers in Agency-funded multi-family housing. These subsidies are administered by HUD or others authorized to administer the program such as a State Housing Finance Agency or the local public housing agency. Projects accepting tenants who use such vouchers assigned by a local public housing agency will also comply with any requirements imposed by that agency.

C. Multiple Subsidies

More than one type of subsidy may be used in a project. The rental subsidy that the tenant is receiving must be less than the full amount of Agency rental assistance for which the tenant would qualify. In such cases, the Agency may provide the difference between the subsidy received by the tenant and the amount of Agency rental assistance for which the tenant qualifies.

There are special tenant codes under Part II, item 6 of the electronic MFIS Tenant Certification to denote what types of subsidy, if any, a tenant is receiving, and whether the tenant is receiving full or partial subsidy from a source other than the Agency.

SECTION 1: ALLOCATION OF AGENCY RENTAL ASSISTANCE

8.3 AGENCY-FUNDED RENTAL ASSISTANCE

The objective of the Agency rental assistance (RA) program is to reduce rents paid by low-income households. RA is the portion of approved shelter cost (rent and utilities) paid by the Agency to the borrower on behalf of a tenant to compensate for the difference between the approved shelter cost and the monthly tenant contribution as calculated on *Form RD 3560-8, Tenant Certification*. When the household's monthly gross tenant contribution is less than the approved utility allowance that is billed directly to and paid by the tenant, the owner will pay the household that difference.

If a prospective tenant with a HUD voucher or other subsidy applies for occupancy and the project has RA or project-based subsidy, the RA or project-based subsidy takes precedence. RA may only be provided to tenants who are income eligible and residing in eligible units. There are four types of RA:

- **Renewal RA** is RA that replaces RA agreements contracts expiring because the obligated funds under the agreement have been fully disbursed. Because the Agency wishes to protect tenants currently benefiting from RA, replacement of RA contracts receive first priority for funding from the Agency.

- **Servicing RA** is RA that increases the number of RA units in a project resulting in an initial RA agreement or an amendment to an existing agreement with a borrower.

- **New construction RA** is RA to accompany new units of multi-family housing.

- **Incentive RA** is RA that is used to help preserve multi-family housing projects as part of the prepayment process. For information about the prepayment process, see HB-3-3560, Chapter 15.

8.4 ALLOCATION AND DISTRIBUTION OF AGENCY RA *[7 CFR 3560.257]*

A. Allocation of RA to the States by the National Office

RA is allocated to the states on an annual basis by the National Office and in an amount based on Congressional appropriations. The National Office uses RD Instruction 1940-L to allocate the RA and to provide guidance to the states on how to distribute the RA among projects.

Before the beginning of the fiscal year, the National Office sends out a survey to each state requesting summary data on the need for RA in each state. These data are used to allocate replacement and servicing RA. New construction RA is allocated to each state based on a formula.

B. Prioritization of RA

In the absence of other guidance from the National Office, states will use the following priorities to allocate RA within the state:

- **Replacements units.** First priority will be for replacing RA units that are expiring.

- **New construction.** Second priority will be for RA to accompany new construction.

  ◊ RA units will be allocated to those projects that are selected for funding under the Notice of Funding Availability (NOFA) system and in accordance with the scoring and ranking system described in Chapter 4 of HB-1-3560.

  ◊ For farm labor housing projects, RA units will be allocated by the National Office from the National Office reserve on a case-by-case basis at the time the projects are considered for funding at the National Office level.

- **Servicing assistance.** Third priority is for RA for existing multi-family housing projects that have requested servicing RA by checking the appropriate box on the budget *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance*.

Incentive RA is not allocated by priority. The National Office allocates incentive RA from a special set-aside of funds.

8.5 PROJECT ELIGIBILITY FOR AGENCY RA *[7 CFR 3560.254]*

To be eligible for RA, a project must be designated as one of the following types according to the loan agreement:

- A Plan II interest credit project. If a project is not currently a Plan II project, it may be possible to change to Plan II and thereby become eligible. Exhibit 8-1 lists which types of projects may switch to Plan II and which may not.

- An off-farm labor housing project. Off-farm labor housing projects that are financed with grants only are not eligible.

- A project financed with a direct or insured Rural Rental Housing Loan approved prior to August 1, 1968. To be eligible, the project must be operated under an interest credit agreement that identifies the housing project as a Plan RA project.

- A project funded by multiple sources, including Agency financing, for which the loan must be a Plan II interest credit loan.

Exhibit 8-1

Project Eligibility for Rental Assistance

Project Type	Eligible	Not Eligible	Can Convert to Plan II
On-Farm Labor Housing		X	NO
Off-Farm Labor Housing	X		
For Profit		X	YES
Plan I		X	YES
Plan II	X		
Section 8/515 with no interest credit		X	YES
Section 8/515 with interest credit reduced by 1%		X	YES
Section 8/515 with interest credit reduced by 2%		X	YES
Section 8/515 with full interest credit	X		

8.6 PROCESSING RA OBLIGATIONS *[7 CFR 3560.255]*

The State Director or a delegated member of the staff approves or disapproves RA requests. *Form RD 3560-51, Obligation Fund Analysis*, is the form that obligates the RA.

When reviewing RA requests, the Loan Servicer must consider the following questions:

- Is the project/unit eligible for RA? The project must meet the requirements specified in Section 8.5.
- Does the project need the RA? The supporting documentation from the borrower must show that there are tenants or applicants who are eligible for the RA.
- Is the RA available for distribution? The state must have the RA units available.

How an RA request gets processed depends upon whether the assistance is for replacement RA, servicing RA, or new construction RA.

A. Renewal and Servicing Rental Assistance

1. Tracking Usage of Agency-Funded RA

The Loan Servicer inputs the information provided by the borrower on *Form RD 3560-29, Notice of Payment Due Report* into the Multi-Family Housing Information System (MFIS). Quarterly and annually, a report is issued by the Office of the Deputy Chief Financial Office (ODCFO) that provides the Loan Servicer with an RA payment and obligation status report for each project. The Loan Servicers should use these reports, in conjunction with the Automated Multi-Family Housing Accounting System (AMAS) to closely monitor their borrower's accounts to ensure maximum utilization of existing RA obligations. If it is determined that RA units are not being used, the procedures in Section 8.8 should be followed to transfer the units.

The Field Office must monitor statewide RA usage so that it can be reported as expiring and needing replacement when the annual survey is sent out from the National Office ascertaining the need for replacement RA.

2. Processing Renewal RA

Renewal RA must not be awarded in an amount that is more than necessary to cover existing expiring contracts. For example, if a 24-unit project has only 18 units of RA that are expiring, the State Director may not award the project more than 18 units of RA.

To the extent that sufficient Federal funds are available, the Agency will automatically renew expiring RA agreements at the existing number of units.

If there is no renewal RA available to give to the borrower due to a lack of Congressional appropriations, the Loan Servicer will inform the borrowers that they must notify the affected tenants of their increased rents and give them the option of terminating their leases with no penalties.

3. HUD Section 8 Housing Assistance Payments

For properties that receive project-based HUD Section 8 assistance, borrowers must provide copies of their Housing Assistance Payments (HAP) contracts to the Loan Servicer. The Loan Servicer must monitor these contracts, particularly their expiration dates.

4. Servicing RA

Borrowers apply for servicing RA by checking a box on the project budget *Form RD 3560-7*, indicating a need for servicing units and certifying that they have looked elsewhere for other rental subsidies. To allocate servicing units to a project, the Loan Servicer must verify that the project is eligible and:

- Existing tenants are paying more than 30 percent of their incomes in rent; or

- There are vacancies in the project and evidence that shows that there are very low-income tenants who would occupy the housing if there were RA units available. Such evidence must be in the form of market data and/or waiting lists.

B. New Construction Rental Assistance

New construction RA is requested with the initial application. The following requirements must be met for the Agency to consider awarding new construction RA:

- The number of RA units requested must be based on the market data for the area, the proposed rental rates as reflected in a budget for the project, and the income levels of the prospective tenants; and

- If the RA is going to be part of a project funded by a participation loan, the Agency participation rate needs to be at least 25 percent of the total development cost.

Chapter 4 of HB-1-3560 provides further details on processing new construction RA.

C. Special Language for FY 2004, 2005 & 2006 RA Obligations.

The FY 2004, 2005 and 2006 appropriation language has established a set term of four years for RA Obligations, only. Therefore, the following instructions should be used for completing Form RD 3560-27, "Rental Assistance Agreement" regarding **ALL** FY 2004, 2005 and 2006 RA obligations.

1. All FY 2004, 2005 and 2006 obligations will ALWAYS need to have a separate Form RD 3560-27.

2. Changes to the form:

a. Above title: "Rental Assistance Agreement" add "FOUR YEAR"

b. Section 8 (a) - cross out "...automatically upon total disbursement or credit rental assistance to the borrower's account" and insert - "four (4) years from _____*_____, unless the funds are fully expended prior to that time."

*If agreement is for the original obligation, enter the date the agreement is prepared.

*If the agreement is for units transferred, enter the date of the agreement from the original *Form RD 3560-27*.

For example, renewal obligation for Borrower A is obligated on April 6, 2006, and the Form RD 3560-27 is signed on April 10, 2006. The expiration of the obligation will be April 10, 2010. If one unit of RA (from the FY 2006 obligation) is transferred to Borrower B on August 15, 2007, then the Form RD 3560-27 for Borrower B will have an expiration date of April 10, 2010, even though the borrower received the unit on August 15, 2007.

For new construction RA obligations, Form RD 3560-27 must be signed during the Fiscal Year of the RA obligation.

A servicing effort tracking item "FY __ RA Obligations" has been established in MFIS to assist in the monitoring of FY 2004, 2005 and 2006 obligations. The National Office will be monitoring this tracking item to assure that funds are being properly monitored.

D. General Approval and Processing Actions

When it has been determined that RA can be obligated, the Loan Servicer will prepare and distribute part III of *Form RD 3560-51* according to the instructions. The State Office will verify the obligation or transfer via the computer terminal on the day following the request. Upon verification that the obligation or transfer has processed in AMAS, the State Office will complete the RA Review process in MFIS. Refer to the MFIS Phase 4 Training Manual for guidance for the RA Review process.

When the State Office verifies that RA units have been obligated, it will forward a copy of *Form RD 3560-51* to the Loan Servicer. The Loan Servicer will complete *Form*

RD 3560-27 and attach the copy of *Form RD 3560-51* according to the instructions on the form. The *Form RD 3560-27* is then filed in the borrower's active case file, and a copy is sent to the borrower.

If RA funds are available but cannot be provided due to a determination of ineligibility, the State Director will inform the borrower in writing of the reasons and provide the borrower information on appeal rights in accordance with 7 CFR Part 11. See paragraph 1.8 of Chapter 1 for an overview of the appeals process.

Loan applicants or borrowers determined to be eligible for RA as a result of an appeal or funding review will receive RA, if RA funding is available. If the funding is available, the applicant or borrower will receive it beginning with the month following the date of the appeal or funding review decision. If the funding is not available, the applicant or borrower will receive it beginning in the first month that RA funding becomes available.

When an RA request is denied because funds are not available from the state's allocation or the National Office reserve, the decision is not appealable.

E. RA Obligation Numbers

AMAS uses obligation numbers to track RA obligations and undisbursed balances. See the AMAS manual for information on tracking RA obligations.

1. Current Obligations

When RA is approved, each RA obligation is assigned a six-digit RA obligation number as follows:

- First two digits represent the fiscal year in which the funds are obligated (e.g., 04, 05, 06, etc.);
- Second two digits represent the number of the RA obligation for each project in sequential order for each fiscal year starting with 01 (e.g., 04-01, 04-02, 04-03, etc.); and
- Third two digits are coded 00 for all obligations.

For example, the fifth RA obligation made in fiscal year 2005 would be coded 05-05-00.

2. Pre-1985 Obligations

RA obligations obligated before 1985 were coded as follows:

- First two digits represent the fiscal year in which the initial obligation was made on the project (i.e., 78, 79, 80, etc.);

- Second two digits relate to the pre-Automated Multi-housing Accounting System conversion loan number to which the RA obligation was processed; and

- Third two digits indicate the number of modifications plus 1. (*Form RD 3560-27,* with two modifications on September 30, 1984, would be designated "03").

8.7 TERMS OF AGREEMENT *[7 CFR 3560.258]*

Form RD 3560-27 is the document that sets out the terms of RA agreement between the Agency and the borrower.

A. Terms of Agreement

Each *Form RD 3560-27* will be effective the first day of the month in which it is executed. If assistance is granted to a project under an appeal, the amount of the assistance will cover what is needed for an effective date retroactive to the first day of the month in which the assistance was denied, provided the borrower agrees to make any appropriate refunds to tenants who would have been entitled to RA during the retroactive term.

Starting in 2004, RA is obligated for 4-year terms. Previously, the Agency issued 5-year RA agreements. The agreement for RA obligations prior to FY 04, expires when the funds obligated for the RA units described in Section 10 of *Form RD 3560-27* are fully disbursed. This can be any time before or after the end of the agreement period. The Agency has in the past issued 20-year and 5-year RA agreements. If and when these are renewed, they are done so for 5-year or 4-year terms.

B. When Agreements May Be Amended

Loan Servicers may amend RA agreements to:

- Add replacement units for the project to the agreement;

- Add or subtract servicing units assigned to the project through obligation, through transfer from another RA obligation, or as an incentive to avert prepayment;

- Reinstate a suspended RA obligation(s) to a new borrower in the same project after a voluntary conveyance or a foreclosure and a credit sale within the Multi-Family Housing program; or

- Transfer a suspended RA obligation(s) to a new borrower and a different project after liquidation of the project assets or after the loan is paid in full.

C. Procedures for Amending Agreements

The following steps are taken to amend agreements.

- Any existing RA obligation executed prior to February 15, 1983, which will have a remaining obligation balance at the end of the expiration date stated in section 9 of the RA agreement, "Term of the Agreement," may be amended. The amended agreement will expire when the obligated funds are fully disbursed.

- For every replacement or modification of an RA agreement that occurs on or after May 1, 1985, the original and all copies of the affected RA agreement will be noted, assembled, and distributed by the Loan Servicer according to the form's instructions. When a *Form RD 444-27A, Amendment to RA Agreement* initiated prior to May 1, 1985, is replaced or modified, a new *Form RD 3560-27* will be prepared and distributed according to the form's instructions.

- The Loan Servicer must use the new form so that eventually all borrowers will be using the new form.

D. Consolidating Agreements

Consolidation of RA agreements is allowed, if the fiscal year and the type of RA are the same.

E. Replacing Expiring Obligations

The Agency will renew all expiring obligations with obligations to the extent funds are appropriated. Expiring 20-year obligations will be replaced with current funding levels.

Expiring RA obligations and replacement RA obligations may run concurrently for a period of 30 to 60 days so any undisbursed obligation balance on the expiring RA agreement can be liquidated.

8.8 TRANSFERRING RA *[7 CFR 3560.259]*

A. Cases in which RA May Be Transferred

The State Director may transfer RA in the following instances:

1. At Project Transfer

When a project is transferred to an eligible borrower, the transferee may assume the transferor's unliquidated RA obligation(s).

2. Following Voluntary Conveyance or Foreclosure Sale

When a project with RA is voluntarily conveyed to the Agency or acquired by foreclosure sale, the RA obligation will be automatically suspended under the borrower's name when the St. Louis Office processes *Form RD 3560-19, Status of REO Property*. The RA for these units will be held in suspension until the final disposition of the acquired property has been determined, at which time the RA will be transferred to a

different Agency-financed project in accordance with paragraph C of this section. During the inventory period, tenants will pay 30 percent of their incomes for rent. Tenants entitled to reimbursement for utilities will be paid from project income.

3. Following Liquidation or Prepayment

The Fiscal Year 2006 appropriations language requires that units from prepaid projects be used for other Section 542 (Vouchers) and Section 502 (Preservation/ Incentives) purposes. Therefore, RA from prepaid projects is not available for transfer and will be held outside of the Administrator's Reserve. These units cannot be moved to other properties.

4. When Not Being Used After Initial Rent-Up

RA that is not being used may be transferred with or without the borrower's consent or request. When RA is unused after initial rent-up (following the construction period) and not needed because of a lack of eligible potential tenants in the area, all or a portion of it may be transferred by the State Director under the following conditions:

- The Loan Servicer recommends the RA transfer after reviewing documentation submitted by the borrower; and

- Available RA units remain unused after a one-year period since initial availability.

5. When Not Being Used 6 Months or Later After the Initial Year of the Agreement

If, after the end of the initial year of an RA agreement, the borrower has not used a portion of the RA units for any ensuing consecutive 6-month period, the State Director may transfer the number of unused units to another project without the borrower's request. If the remaining unit(s) remains unused after an additional 6-month period, the State Director may authorize its transfer to another project. This would apply only if the current agreement is on *Form RD 3560-27,* and when:

- The Loan Servicer has reviewed the project occupancy list and verified that there is no apparent RA need in the project;

- The State Director has notified the borrower at least 30 days in advance of the Agency's intent to transfer the RA units and has given the borrower appropriate appeal rights;

- If the borrower appeals the decision, the appeal is resolved in accordance with 7 CFR Part 11 before any transfer action is taken; and

- The transfer will take place in accordance with transfer procedures described in subparagraph D below.

6. Due to an Unclosable Loan

When RA will be unused because the loan to which it was obligated will not be closed or the RA agreement is not signed, the RA obligation may not be transfered except when the circumstances allow for the funds to finance the project to be transferred as well. However, if this situation occurs during the same fiscal year of obligation, the obligation must be canceled and reallocated immediately using current authorities. Obligations from prior fiscal years must be canceled and will be lost unless the conditions allow the financing for the project to be transferred, in which case the RA may be transferred as well.

7. In Response to a Disaster

If a disaster renders a project temporarily or permanently uninhabitable, the RA may be transferred.

8. Due to a Servicing Action

The State Director will suspend RA in a project where the loan has been accelerated to the extent that no payments will be credited to the project's account. Interest credit will be credited to the project's account until the appeal period for the acceleration has expired. After the expiration of the appeal period, if it is determined that foreclosure will proceed, the interest credit will be canceled as of the last day of the month in which the appeal period expired. RA will be automatically suspended by the interest credit cancellation.

That portion of the monthly RA not needed to pay the project monthly installment and other charges, including any delinquencies, overage, and late fees may be processed and returned to the project operating account to maintain project operation. RA agreements expiring during the acceleration and appeal process may be renewed in order to continue payment of RA for this purpose, but only if a third party is managing the project to ensure the proper use of project funds.

After final disposition of the acceleration, expiration of the appeal and redemption period of the defaulting borrower, the RA will be either transferred with a credit sale, transferred to a different project when the defaulting project is sold outside the program, or reinstated to the same project as follows:

- **Transferred with a credit sale.** If the project is sold through a credit sale to an eligible borrower within the program, the suspended RA should be transferred from the previous borrower's case number and project number to the new case number and project number. *Form RD 3560-55, Multi-Family Housing Transfer of RA*, will be attached to *Form RD 3560-19.*

- **Transferred to a different project.** If a defaulting project is sold outside the program, the RA must be transferred to a different project.

- **Reinstated to the same project.** When defaults are corrected, the State Director may reinstate the RA to the borrower's account.

The State Director will apprise the borrowers of their appeal rights under 7 CFR Part 11 upon notification of the pending suspension. The suspension will not be effective until these appeal rights have been exhausted.

B. Eligible Units

In order to be eligible for RA, units must be eligible for interest credit in terms of habitability. Should a fire, natural cause, or other damage render a unit uninhabitable, the RA may be suspended during rehabilitation or it may move with a tenant to a temporary location in another project financed by the Agency.

C. Transferring RA for Displaced Tenants

The State Director may transfer RA from one project to another eligible multi-family housing project to which a tenant is moving due to displacement as a result of prepayment, liquidation, or a natural disaster for that tenant's initial use.

The displaced tenant will be given first priority for an RA unit, regardless of other priorities for the RA, if all of the following conditions are met:

- The borrower is eligible to receive and administer RA.
- The tenant is eligible to occupy the project and to receive RA.
- The tenant has taken all of the following steps to ensure eligibility to receive priority for the unit of RA:
  - ◊ Placed on at least one waiting list for an Agency-financed project with a *Handbook Letter 201 (3560), Letter of Priority Entitlement (LOPE).*
  - ◊ Moved to the project as soon as the name was reached on a waiting list, even if it meant temporarily occupying an ineligible unit. The ineligible unit may not differ from the one for which the tenant is eligible by more than one bedroom.
  - ◊ Moved to an eligible unit as soon as one was available.
- The RA has not previously been transferred for the tenant's current displacement.

D. Process for Transferring

Only the State Director may approve an RA transfer. RA may be transferred to any borrower with an RA eligible project according to the priorities established in this handbook or by the National Office. All or any portion of the units in an RA agreement with an undisbursed balance may be transferred from one project to another.

When the State Director approves an RA transfer, the Loan Servicer uses *Form RD 3560-55*, completed according to the instructions, to notify the St. Louis Office.

AMAS determines the per-unit value of the RA obligation being transferred by dividing the undisbursed balance of the RA obligation on the date the transfer is processed by the number of RA units in the agreement. The number of units being transferred times the per-unit value equals the total amount transferred. After the transfer processes, the Loan Servicer must enter the dollar amount of the transfer in the remarks area of *Form RD 3560-55*.

RA units identified by different RA obligation numbers may be transferred. New RA obligation numbers should be assigned according to the instructions for *Form RD 3560-55* and as described in paragraph 8.6 E.

The Loan Servicer will complete *Form RD 3560-27* with *Form RD 3560-55* attached. These will be completed according to the instructions for each transferee. The transferee may use the transferred units effective the first day of the month in which the transfer is approved. Borrowers must assign the rental assistance units, in accordance with the established priorities identified in Exhibit 8-2, as soon as they become available.

The Loan Servicer will amend the transferor's *Form RD 3560-27* by attaching a copy of *Form RD 3560-55* according to the instructions to indicate that a portion of the agreement has been transferred. When all RA units on a RA agreement have been transferred, the transferor's present agreement will be so documented.

SECTION 2: ADMINISTRATION OF RENTAL ASSISTANCE

8.9 CORRECTIONS TO RENTAL ASSISTANCE PAYMENTS

A. Administrative Errors

The borrower is responsible for correcting any errors made in the administration of the RA program that are made by the borrower or the borrower's authorized management agent. Errors in computation or other unauthorized use of RA will require, at a minimum, the repayment of incorrectly advanced RA funds. Agency requirements regarding unauthorized assistance as established under 7 CFR part 3560, subpart O, apply whenever any RA has been incorrectly advanced.

If the error or unauthorized use of RA appears to be deliberate or intentional, the State Director will refer the case to the OGC. For more information on unauthorized assistance, see HB-3-3560, Chapter 9.

B. Canceling an RA Check

When an RA check needs to be canceled, such as when it is returned, or if the borrower must return an RA payment, an MS2 transaction must be entered directly into the AMAS. Specific instructions for completing this transaction can be found in the AMAS On-Line Manual. This transaction will not be processed until the funds have been received by the Agency through one of the following methods:

- The original U.S. Treasury check covering the RA is returned.
- The borrower submits a check made payable to the Agency to the Field Office for all or a portion of the monthly RA payment that needs to be returned.

8.10 ASSIGNING RENTAL ASSISTANCE TO TENANTS AND APPLICANTS *[7 CFR 3560.257]*

Because RA is limited, the Agency has established procedures to ensure that it is distributed consistently and to the most needy households.

A. Eligible Households

Households which are eligible for RA are those:

- With very low or low incomes who are eligible to live in multi-family housing projects;
- With net tenant contribution determined in accordance with 7 CFR 3560.203(a)(2) that is less than the current basic rent for the unit; and

- Who have a signed an unexpired *Form RD 3560-8* on file with the borrower.

To determine priority for assigning an available RA unit in an operational project, the borrower must update the latest *Form RD 3560-29* for the project as of the date the unit is available.

B. Priorities in Existing Projects

When assigning available RA, borrowers must use the priorities identified in Exhibit 8-2.

Exhibit 8-2

Five Priorities for Assigning Rental Assistance

- First priority is always to eligible very low-income tenants paying the highest percentage of their adjusted annual income in shelter costs.
- Second priority is to very low-income applicants on the waiting list, considering the applicant's unit size and type needed.
- Third priority is to eligible low-income tenants paying the highest percentage of their adjusted annual income in shelter costs.
- Fourth priority is to eligible low-income applicants on the waiting list.
- Final priority is to households that are residing in a rental unit for which they do not qualify on the basis of an occupancy waiver or other special approval situations

In order to provide RA to the third, fourth, and final priority categories, a borrower must fully document that either there are no very low-income households on the waiting list or fully document that occupancy by low-income households is limited as follows:

- For projects occupied on or after November 30, 1983, no more than 5 percent of the units in the project are occupied by low-income households; or

- For projects occupied before November 30, 1983, no more than 25 percent of the units in the project are occupied by low-income households.

Borrower documentation of these circumstances must be kept in the borrower's files and made available to the Loan Servicer upon request.

C. Assigning RA in Newly Constructed Units

A borrower with RA units for a newly constructed project should accept applications for occupancy during the construction phase of the project, after the preconstruction conference has been held. The names of the applicants should be placed on a waiting list. During the initial rent-up period, the following priorities will apply:

- Until all the RA units have been assigned, a number of apartment units in the project equal to the number of RA units will be initially reserved for eligible tenants who qualify for RA, even if there are applications on other lists that applied earlier. Applications qualifying for RA will be considered according to the priority established for existing projects, by passing those applicants on the waiting list whose income is above the low-income limits for the area. The remaining units equal to the number of units that will not be subsidized with RA can be rented simultaneously to other applicants.

- If a substantial number of apartment units reserved to be used with RA units remain vacant after initial rent-up and the borrower could rent those units to applicants ineligible for RA, the borrower may request a transfer of unused RA units. However, applicants ineligible for RA cannot be selected to occupy units initially reserved to be used with RA until the unused RA units are transferred.

- If there are still vacant units, those applicants bypassed because they did not qualify for RA will be considered for occupancy on a first-come, first-served basis.

D. Continued Eligibility

Eligible tenants receiving the benefits of RA may continue receiving such benefits as long as they remain eligible for occupancy, are eligible for RA under 7 CFR 3560.254(c)(2), and RA units are available.

E. Timing of RA Assignment

Rental assistance is paid to the borrower on the first of the month based on the prior month's occupancy.

When a tenant who has been receiving RA vacates the project, the borrower must immediately assign that unit of RA to the next existing eligible tenant or applicant on the waiting list.

When a tenant receiving RA vacates before the end of the month and the borrower reassigns the RA, the Agency will provide RA for the newly designated tenant starting on the first day of the following month.

When an RA unit is assigned to an eligible existing tenant on a day other than the first day of a month, the Agency will not provide rental assistance for the newly assigned existing tenant and the tenant will not pay reduced rental charges until the first day of the month following the assignment of the rental assistance.

F. Incorrectly Assigned RA

Incorrectly assigned RA is viewed as unauthorized assistance and handled in accordance with the requirements established under 7 CFR part 3560, subpart O.

When the tenant has correctly reported income and household size but RA was assigned to a household in error, that tenant's RA benefit should be canceled and reassigned. Incidents involving incorrect reporting are handled in accordance with the unauthorized assistance requirements established under 7 CFR part 3560, subpart O.

Before the borrower notifies the tenant, the borrower or management agent shall review the case with the Loan Servicer. If the Loan Servicer verifies that an error has been made based on information available at the time the unit was assigned, the tenant will be given 30 days' written notice that the unit was assigned in error and that the RA benefit will be canceled effective on the next monthly rental payment due date after the end of the 30-day notice period. It should be noted that some states require a 60-day notice of rent increases, in which case the written notice must be extended to 60 days. The borrower will also notify the tenant in writing that:

- The tenant has the right to cancel the lease based on the error made by the borrower and the loss of benefit to the tenant;
- The RA granted in error will not be recaptured from the tenant; and
- The tenant may meet with management to discuss the cancellation and the facts on which the decision was based. If the facts are accurate and the tenant cannot produce further evidence proving eligibility for RA, there will be no appeal for the decision. If the tenant feels there is justification for further review, the borrower must give the tenant appeal rights under 7 CFR 3560.160.

The RA unit will be reassigned to the next eligible household, based on *Form RD 3560-29* from which the original priority was established, when the unit was erroneously assigned. The RA will not be retroactive unless the reassignment was based on an appeal by the tenant. Retroactive RA may not exceed the project's remaining RA obligation balance.

Tenants may appeal determination of ineligibility for available RA under 7 CFR 3560.160. See paragraph 1.8 of Chapter 1 for information on the appeals process.

G. Dealing with Tenants Who Attempt to Receive RA Simultaneously in Two Different Projects

A tenant may not receive RA in two different multi-family housing projects at the same time. If part of the household is occupying a unit and the tenant attempts to occupy a seasonal unit in another project, MFIS will identify the duplicate tenancy through the tenant's Social Security Number.

8.11 TENANT PAYMENTS *[7 CFR 3560.256(d)]*

A. Rents

Tenants receiving RA must pay the net tenant contribution toward rent, which will not exceed the higher of:

- 30 percent of monthly adjusted income, with an adjustment for any utility allowance; or

- 10 percent of gross monthly income, with an adjustment for any utility allowance.

B. Utilities

The utility allowance for a project with RA is determined as it is for any other project. As for non–RA projects, the utility allowance is reviewed annually for accuracy and changes are made when necessary.

When the tenant is billed directly for utilities, rent paid by the tenant receiving RA will be the difference between the established utility allowance and the net tenant contribution as determined by 7 CFR 3560.203.

- Example: Assume a basic rent of $250 and a utility allowance of $50. Patty Duke's adjusted monthly income is $400. Thirty percent of her adjusted income is $120. Fifty dollars is deducted from the $120 to allow her to pay her utilities, leaving her a net tenant contribution of $70 for rent to the borrower. The Agency pays RA to the borrower on behalf of Patty Duke in an amount of $180 to total the $250 basic rent.

When utilities are paid by the household receiving RA and the net tenant contribution is less than the allowance for utilities, the borrower will pay the household the difference between the utility allowance and net tenant contribution.

- Example: Assume a basic rent of $250 and a utility allowance of $50. Jane Ronda's adjusted monthly income is $160. Thirty percent of her adjusted monthly income is $48, which is less than the utility allowance. The Agency will pay $252 in RA to the borrower to cover the $250 basic rent and the extra $2 that the borrower must provide to the tenant to allow her to meet the $50 utility allowance.

In a project where the borrower pays all utilities, the tenant rent will be the net tenant contribution as per 7 CFR 3560.203 up to the approved rent for the rental unit being occupied.

- Example: In a project where the basic rent is $300 and there is no utility allowance, RHS would pay the borrower $180 for Patty Duke, who would pay the whole $120 in rent, totaling the required rent payment of $300. For Jane Ronda, the Agency would pay $252 to the borrower in RA and Ms. Ronda would contribute her $48 to make the total $300 rent payment.

SECTION 3: OTHER RENTAL SUBSIDIES

8.12 HUD RENTAL SUBSIDY *[7 CFR 3560.260]*

The Agency encourages the use of HUD Section 8 vouchers.

A. Project-Based Assistance

Tenants in Section 8/515 units must pay rents and utility allowances in accordance with HUD requirements.

B. Tenant-Based Assistance

Families using vouchers must be initially eligible as per program rules *[7 CFR 3560.152]*. The public housing authority issuing the vouchers will be responsible for an annual examination of household income and family composition. The public housing authority will adjust the housing assistance payments made on behalf of the family to reflect any changes in the family's monthly adjusted income, size, or composition.

For tenants with HUD vouchers, the borrower must set the rent for each unit occupied by a voucher holder at the basic rent or the rent standard set by the public housing agency, whichever is higher. The borrower must remit the value of the voucher exceeding the basic rent up to the note rate rent to the Agency. The public housing agency distributing the HUD Section 8 subsidy may set the utility allowance.

Once a HUD assistance contract expires, recertification responsibility reverts to the borrower, and Agency form and income verification and certification requirements apply.

8.13 OTHER SOURCES OF RENTAL SUBSIDY *[7 CFR 3560.260]*

The Agency may authorize other types of rental subsidies to be used in new or existing projects but will make no commitment to providing RA at the expiration of the project-based rental subsidy agreement from other sources.

A. Agency Requirements for New Construction Projects Proposed with Non–Agency Rental Subsidy

For the Agency to consider a new project with non-Agency rental subsidy, the applicants must demonstrate that:

- A market exists for the assistance and at income levels that would benefit from the subsidy being provided;
- Once the rental subsidy is no longer available, an adequate rental market exists for the project without assistance; and
- Tenants will not be displaced at the end of the subsidy agreement.

Applicants will specify how they intend to meet the above requirements through two documents: the memorandum of understanding with the provider of the RA and the Project-Based Rental Subsidy Agreement.

B. Formalizing the Project-Based Rental Subsidy

Rental subsidy for new and existing projects is formalized through two main documents: the memorandum of understanding, which is between the Agency and the provider of the rental subsidy, and the Project-Based Rental Subsidy Agreement, which is the instrument agreement involving the tenant, borrower, and provider of assistance.

1. Memorandum of Understanding

The Agency must enter into a memorandum of understanding with the provider of the rental subsidy to make sure that the Government's interests are secure. This memorandum of understanding must include the following provisions:

- The reason for providing the project-based rental subsidy and its intended purpose;
- The length of time the project-based rental subsidy will be provided;
- Actions to be taken at the end of the project-based rental subsidy agreement to minimize the effect on tenants losing the rental subsidy and to avoid displacement; and
- A copy of the proposed project-based rental subsidy agreement.

2. The Project-Based Rental Subsidy Agreement

The Project-Based Rental Subsidy Agreement is the instrument of agreement involving the tenant, borrower, and provider of assistance.

The Agency will not be a party to the Project-Based Rental Subsidy Agreement nor have any responsibilities under the agreement. However, the Loan Servicer must ensure that the Project-Based Rental Subsidy Agreement provides that:

- The rental subsidy payments will be paid directly to the tenants or deposited to a separate project operating account established for this purpose. The tenants must be advised of the amount and source of the subsidy through the lease or supplement to the lease.
- The life of the Project-Based Rental Subsidy Agreement must be similar to existing or current Agency RA funding levels, and sufficient funds must be set aside in a way that ensures availability of project-based rental subsidy for this term. The method of supplying the funds must be clearly set forth and acceptable to the Agency.
- During the term of the Project-Based Rental Subsidy Agreement, the provider must make available the subsidy amounts required at least annually.

C. Low-Income Housing Tax Credit Projects

For projects with low-income housing tax credits (LIHTCs), if the project-based rental subsidy term is less than the LIHTC compliance period, the borrower must demonstrate the marketability of the project-based rental subsidy units by either:

- Demonstrating that there are sufficient households within the LIHTC income limits to support the units without rent overburden; or
- Certifying that the targeted percentage of LIHTC units (not the minimum set-aside option) does not include the project-based rental subsidy units, so that the units will be marketable to households in all Agency program eligible income ranges.

SECTION 4: LABOR HOUSING REQUIREMENTS FOR RENTAL ASSISTANCE

8.14 USING RENTAL ASSISTANCE AS OPERATING ASSISTANCE *[7 CFR 3560.574]*

The Agency's rental assistance program, which provides assistance based on each household's income, can be difficult to administer in housing for migrant workers because of frequent tenant turnover and short periods of occupancy.

Borrowers of section 514 or 516 funds for Off-Farm Labor Housing projects may use Agency rental assistance funds for operating assistance rather than for providing rental assistance to individual households. By using operating assistance to reduce operating costs, rental rates can remain lower so that they are affordable to tenants based on the average wages of migrant farmworkers in the area. Tenants in Off-Farm Labor Housing projects that are receiving operating subsidy are still required to provide income verification and household income must be within the very-low or low-income limits to qualify for reduced operating assistance rents. Borrowers must provide documentation of tenant incomes to the Agency.

8.15 PROJECT ELIGIBILITY FOR OPERATING ASSISTANCE

Only Off-Farm Labor Housing project units that are designated for migrant farmworkers are eligible to receive operating subsidy. The property must be eligible to receive rental assistance.

8.16 OPERATING SUBSIDY LIMITS

The amount of operating assistance requested by the owner must be based on the project's actual income and expenses and must be approved by the Agency. For projects with both migrant and year round farmworkers, the amount of operating assistance is based on the portion of actual income and expenses attributable to the units that are for migrant farmworkers. In no instance may the annual amount of operating assistance exceed 90 percent of the annual operating costs that are attributable to the migrant units.

8.17 OWNER RESPONSIBILITIES.

A. Requesting for operating assistance program

Owners of Off-Farm Labor Housing projects with units for migrant farmworkers may request operating assistance by submitting a request to the Agency, which must include a budget. The budget must include:

- Estimated operating costs for the migrant units, including authorized expenditures such as reserve deposits;

- Proposed rental rates for the migrant units to generate sufficient funds for operating costs of those units, taking into consideration all other sources of project income; and

- Estimated rental income from tenants, based on a tenant contribution of 30 percent of the average adjusted monthly income of migrant farmworker households in the area.

B. Requesting operating assistance payments

Each month, the owner will submit a request for operating assistance to the Agency.

C. Verifying tenant income eligibility

Owners are responsible for verifying tenant income eligibility. Only very low or low-income households are eligible for the operating assistance rents. Households with incomes above the low-income limits must pay the full rent.

D. Reporting requirements

Owners will complete and submit to the Agency tenant certifications to document tenant income and eligibility.

Owners will complete and submit monthly to the Agency a project worksheet for operating assistance.

Owners must submit an annual planning budget to the Agency prior to the project's fiscal year.

CHAPTER 9: AGENCY MONITORING
[7 CFR part 3560, subpart H]

9.1 INTRODUCTION

When borrowers accept Agency loan and grant funds, they agree to operate the property in accordance with program objectives and comply with program requirements established by the Agency. To ensure that borrowers meet these responsibilities, the Agency monitors borrower performance and takes action as needed to see that borrowers fulfill their responsibilities. The previous chapters have described the program requirements for multi-family housing projects and the Agency's procedures for implementing these requirements. This chapter describes the Agency's procedures for monitoring multi-family housing projects to ensure that these requirements are met.

Section 1 of this chapter provides an overview of Agency monitoring activities. Section 2 describes the procedures for Servicing Offices' monitoring activities. Section 3 discusses monitoring farm labor housing projects for compliance with program requirements. Section 4 provides an overview of State Office oversight of servicing activities. Section 5 provides for National Office initiatives and oversight.

9.2 AGENCY MONITORING OBJECTIVES AND PRIORITIES

A. Monitoring Objectives

The Agency will monitor project operations to:

- Ensure the project is managed in accordance with the goals and objectives of the Multi-Family Housing program;
- Preserve the value of the property;
- Ensure that the property is maintained in accordance with Agency requirements for providing housing that is decent, safe, sanitary, and affordable;
- Ensure that the project is operated at actual, necessary, and reasonable costs;
- Detect waste, fraud, and abuse;
- Verify compliance with occupancy requirements; and
- Ensure compliance with affirmative fair housing marketing requirements; Title VI of the Civil Rights Act of 1964; Title VIII of the Civil Rights Act of 1968, as amended; Section 504 of the Rehabilitation Act of 1973; the Age Discrimination Act of 1975; the Americans with Disabilities Act of 1990; other applicable Federal, state, and local laws; and Agency requirements related to occupancy and tenant eligibility.

B. Monitoring Priorities

The Agency will monitor the performance of all borrowers. However, to make the best use of its available resources, the Agency will give priority in its monitoring efforts to borrowers with projects that have the greatest risk of poor performance or compliance violations. By focusing more attention on projects experiencing problems, the Agency can maximize the effect of its monitoring activities. Agency monitoring efforts involve three levels of activities:

- **Routine monitoring.** For projects with limited risk of performance or compliance problems, Loan Servicers will conduct routine monitoring. This level of monitoring involves regular checks of project compliance through reviews of regular borrower submissions and periodic on-site visits.

- **Intensive monitoring.** For projects with a higher risk of performance or compliance problems, Loan Servicers will conduct intensive monitoring. This level of monitoring involves not only regular checks of project compliance, but also more frequent borrower reporting and on-site visits by Agency staff.

- **Quality control.** While Loan Servicers conduct routine and intensive monitoring, State Offices are responsible for oversight of Field Office monitoring efforts. The National Office will establish a set of goals for Field Office performance. The State Office must use Multi-Family Housing Information System (MFIS), Automated Multi-Family Housing Accounting System (AMAS), and other monitoring reports to ensure that Field Offices are meeting these goals. Additional State Office oversight of Field Office performance is conducted through the State Internal Review (SIR) process.

9.3 BORROWER RESPONSIBILITIES

Borrowers are responsible for cooperating fully with the Agency staff performing monitoring activities. The Agency will notify borrowers in writing of any deficiencies or compliance violations identified during its review. Borrower must address these deficiencies within the correction period established by the Agency and described in the notice.

SECTION 1: OVERVIEW OF AGENCY MONITORING

9.4 AGENCY MONITORING REVIEWS

A. Key Parties in the Monitoring Process

Monitoring involves a range of staff from the Agency and throughout the department. Borrowers, their management agents, and tenants also need to be active participants in the monitoring process. Exhibit 9-1 lists the key parties in the monitoring process.

Exhibit 9-1

Key Participants in the Monitoring Process

USDA Staff	Other Parties
• Loan Servicer • Architectural/Engineering staff • Environmental staff • Civil Rights staff • Office of General Counsel (OGC)	• Borrower • Management agent ◊ Manager (On-site or Off-site) ◊ Supervisor ◊ Project staff (e.g., leasing, maintenance) • Tenants

1. USDA Staff

Effective monitoring of borrower performance requires a coordinated effort on the part of Agency staff from several areas. While Loan Servicers hold primary responsibility for monitoring borrowers and their projects, staff from other offices will often assist in performing monitoring reviews. For example, the State Architect/Engineer will often need to assist in performing physical inspections when Loan Servicers have specific concerns about a project. When performing reviews of the central office of a management agent with properties in several states, Loan Servicers will need to coordinate with their counterparts from the respective states. Finally, if monitoring activities identify significant deficiencies, Loan Servicers will often need to obtain the advice of staff from OGC.

2. Borrowers, Management Staff, and Tenants

While the Agency holds responsibility for performing monitoring activities, effective monitoring also requires the cooperation of borrowers and their agents. Their involvement during monitoring reviews is needed to provide access to records and to answer questions about project operations and procedures. Further, when deficiencies are discovered, borrowers, as well as the management agent, need to be informed so that prompt action can be taken to correct the problem. Borrowers notified of deficiencies are responsible for ensuring that the problems are corrected and for keeping the Agency informed about actions taken to address the problems.

Tenants are important participants in the monitoring process because they can provide valuable information about project operations.

B. Monitoring Methods and Activities

The Agency uses two basic types of monitoring methods:

- **Desk reviews.** These reviews involve examining project reports submitted by the borrower. Generally, Loan Servicers perform these reviews.

- **On-site reviews.** These reviews are conducted at the project and involve the inspection of both project conditions and records. Loan Servicers will often draw on the technical expertise of other staff to assist in performing these reviews.

The specific reviews that fall into each category are summarized in Exhibit 9-2. Each of these reviews is described in greater detail in subsequent sections of this chapter.

Exhibit 9-2

Agency Monitoring Reviews

Desk Reviews	On-site Reviews
Quarterly/Monthly reports	Post-occupancy review
Annual project financial report	Annual physical reviews
Occupancy trends/vacancy turnover	Triennial Supervisory Visit includes:
Unused rental assistance	On-Site review
Agency internal quality control	Occupancy review
Tenant subsidy review	Management review
	Full Physical Inspection
	Compliance review

C. Key Documents and Sources of Information

The Agency relies on a range of sources to perform its monitoring activities. These sources are summarized in Exhibit 9-3.

Exhibit 9-3

Key Sources of Information for Agency Monitoring

Agency Records	Project Records	Other Sources
Project Case File	Notice of Payment Due Report	On-site visits by Agency staff
Loan agreement/resolution	Project budgets/Utility Allowance	Reports from other Agency staff
Interest credit agreement	Annual financial report	Tenant reports/complaints
Rental assistance agreement	Financial records	Reports/Information from local officials
Affirmative Fair Housing Marketing Plan	Tenant files (eligibility documentation)	Reports/Information from community members
Lease	Marketing records and applications	Compliance monitoring and inspection reports received from other financing or subsidy sources involved with the property
Management certification	Waiting lists	
Management plan	Maintenance records	
Form RD 3560-52, Promissory Note	Occupancy policies	
Annual financial statements	Occupancy rules	
Borrower organizational documents	Tenant Certifications	
Plans and Specifications		
Automated Systems		
AMAS		
MFIS		

1. Agency Records

The project case file and other Agency records provide information about the specific responsibilities of the borrower and also the operation of the project. As discussed in previous chapters, program requirements vary depending on the type of project and the type of financing the borrower received. The case file documents indicate the type of project and the specific terms of the Agency's financing. For example, these documents specify the replacement reserve requirements and the owner's return on investment. The case file also contains the management certification and management plan, which provide key information about project operations.

Agency records include the automated systems used to administer the program. AMAS and MFIS contain information that aid in monitoring projects.

Official records contain legal evidence of all transactions between the Agency and the persons with whom it conducts business. For information about the required contents and organization of the borrower case file, see RD Instruction 2033-A.

2. Project Records

Project records are documents that provide information about the on-going operation of the project. Notice of Payment Due Report (*Form RD 3560-29*), Multiple Family Housing Project Budget/Utility Allowance (*Form RD 3560-7*), and Tenant Certification (*Form RD 3560-8*) are examples. Loan Servicers examine these records during monitoring reviews to evaluate project performance and compliance.

3. Other Sources

In addition to site visits conducted by Loan Servicers or other staff to observe project operations, the Agency also draws on other sources to inform monitoring activities. Substantiated reports by tenants or community members noting inadequate conditions or improper practices are examples. Reports of performance problems in other states involving the same borrower or agent are also a source of concern. This type of information does not necessarily confirm that a problem is present, but indicates a need for further review of a project's operations.

9.5 PLANNING MONITORING ACTIVITIES

Planning monitoring activities involves scheduling routine reviews and determining the extent to which in-depth monitoring needs to be conducted. Loan Servicers and State Office staff should review annually their plan to monitor their portfolio. Exhibit 9-2 indicates the reviews that are performed routinely and those classified as in-depth reviews.

A. Routine Monitoring

Each year, Loan Servicers must schedule routine monitoring reviews and designate the staff that will perform these functions. These activities—together with the regular program administration activities performed by Loan Servicers—ensure that all projects receive a basic level of oversight each year to check for evidence of deficiencies or potential problems.

In scheduling these activities, Loan Servicers need to ensure that the appropriate staff is available to perform these reviews. Annual physical reviews should be planned to coincide wherever possible with other activities that take staff to the vicinity of the projects. In cases where access to individual units is required for inspection, the borrower will be required to provide adequate notice to the tenants.

B. In-Depth Monitoring

When planning monitoring activities for the year, Loan Servicers must determine which projects warrant in-depth reviews and the types of reviews needed. In-depth reviews are done periodically to check for continued project compliance. These reviews are also performed more frequently for projects experiencing distress or when there is clear evidence of compliance concerns.

Loan Servicers may schedule these reviews to take place at any time during the year. They may also need to be scheduled on short notice during the year in response to evidence of problems. When scheduling these reviews, Loan Servicers will need to coordinate with the other staff participating in the review (e.g., architectural staff).

9.6 PERFORMING MONITORING REVIEWS

A. Desk Reviews

Desk reviews are usually performed solely by the Loan Servicer and require little coordination with other staff. Performing these reviews generally involves three basic steps:

- **Preparing and reviewing background material.** Loan Servicers should gather the project case file and assemble past reports and other relevant records. In addition to reviewing these documents, Loan Servicers should review the relevant screens in AMAS and MFIS to gain an up-to-date understanding of the project's status and potential concerns.

- **Examining the borrower's monthly and quarterly reports.** Loan Servicers then review the borrower's monthly or quarterly reports following the specific instructions in Section 2 of this chapter or using the instructions that accompany the Agency's review form. Loan Servicers must make every effort to complete the review within the established time period. If additional information is needed to complete the review, Loan Servicers should promptly contact the borrower to request additional information.

- **Notifying borrower of any findings.** If the review reveals deficiencies or compliance violations, the borrower must be promptly notified. The notice must describe the deficiencies and a period for corrective action. If a third party is involved in financing or providing subsidy to the property and a formal arrangement exists with this third party, the Agency will provide a copy of the notice to the third party source to share information concerning the Agency's findings.

Refer to Chapter 4 of this Handbook for details concerning financial reports.

B. On-site Reviews

On-site reviews take more preparation and planning than desk reviews. Loan Servicers must follow the four steps below when performing on-site reviews. The actions at each step will vary depending on the type of review. The specific actions for individual reviews are discussed in Section 2 of this chapter.

1. Preparing for the Visit

Loan Servicers should notify the borrower at least 2 weeks prior to a visit. The notice should specify the types of preparations (if any) that the borrower must complete to assist with the review. The Agency retains the authority to visit the project without prior notice to observe conditions and operations and to conduct on-site reviews without the presence of the borrower or the borrower's agent.

The Loan Servicer should also coordinate with other staff who will participate in the review to clarify assignments and responsibilities. In cases where access to individual

units is required for inspection, the borrower will be required to provide adequate notice to the tenants.

The Loan Servicer should also review the relevant Agency records and project reports to learn the project's current status and identify potential issues that should receive special attention during the review. Finally, the Loan Servicer should fill in the background information items on the monitoring instrument or reporting form.

2. Conducting the Visit

When conducting an on-site visit, Loan Servicers should conduct an entrance interview with the manager and borrower, if available. During this meeting, the Loan Servicers should explain the purpose of the review, describe the major activities, and indicate the type of cooperation that will be needed from project staff.

When conducting the review, Loan Servicers should follow the procedures described in Section 2 of this chapter and the instructions that accompany the monitoring tool. Loan Servicers must carefully record their observations to ensure that problems are not missed or incorrectly identified.

Upon completing the review, the Loan Servicers should briefly consolidate their results and meet with the manager or borrower to present the initial findings from the review. The Loan Servicer should highlight any findings and/or violations at this meeting.

3. Notifying the Borrower

The Loan Servicers must prepare a written description of the review results for the project case file. They must also issue a letter to the borrower summarizing the conclusions of the review and indicate any follow-up actions the borrower is required to take.

This letter is sent to the borrower within 30 days of the site visit or inspection. This letter requests the borrower to respond with procedures and time frames for correcting the noted deficiencies within 30 days. The purpose of the letter is to:

- Notify the borrower of review findings; and
- Provide time frames for resolving deficiencies.

As is the case with desk reviews, if a third party is involved in financing or providing subsidy to the property and a formal arrangement exists with this third party, the Agency will provide a copy of the notice to the third party source to share information concerning the Agency's findings.

4. Follow-Up Activities

If a review identifies deficiencies that require borrower action, the Agency needs to conduct follow-up actions as appropriate to ensure that the deficiencies are corrected. For information about findings and default situations, see HB-3-3560, Chapter 10. A copy of the letter is placed in the borrower's case file and must be entered on MFIS.

9.7 PROJECT CLASSIFICATION

The project classification system allows the Agency to focus on those projects that Loan Servicers consider truly at risk. The following paragraphs provide a brief description of how the Agency views the classification of the portfolio.

Loans may be reclassified in MFIS as findings and violations are determined or as project conditions improve.

CLASS D PROJECTS

Class D projects are in default and may be taken into inventory, be lost to the program, or cause the displacement of tenants. Defaults can be monetary or non-monetary. For information about monetary and non-monetary defaults, please refer to HB-3-3560, Chapter 10.

Projects in non-monetary default are those where a Loan Servicer has notified the borrower of a violation using the Agency's three processing letter process, as described in this chapter, and the borrower has not addressed the violation to the Loan Servicer's satisfaction <u>within 60 days</u> of the first servicing letter. The Loan Servicer, State Office, and National Office should be aware that the project is in jeopardy and should be available to provide further servicing assistance.

CLASS C PROJECTS

Class C projects are projects with identified findings or violations, which are not associated to a workout plan and/or transition plan. They include projects with violations where *Handbook Letter 301 (3560)* has been issued but <u>60 days</u> have not passed. It is important to note that while the presence of a finding or violation is a normal occurrence in portfolio management, Loan Servicers will be concerned when findings and violations are carried for an extended period of time with no indication of resolution efforts. Projects under this classification for an extended period of time will alert Loan Servicers to one or more of the following:

1. There may be workload or staffing issues related to resolving problems;
2. Findings may need to be elevated to violations to facilitate effective servicing; and
3. Assistance from the State Office or the National Office may be necessary to address the problem

CLASS B PROJECTS

A Class B designation indicates that the Agency has taken servicing steps and the borrower is cooperating to resolve identified findings or violations by associating a work-out plan and/or transition plan.

CLASS A PROJECTS

Class A projects have no unresolved findings or violations.

SECTION 2: SERVICE OFFICE MONITORING

9.8 POST-OCCUPANCY REVIEW (90-DAY VISIT)

A. Purpose of the Review

The post-occupancy review verifies borrower compliance with program requirements for project occupancy during initial lease-up and looks at whether the procedures described in the Management Plan and Affirmative Fair Housing Marketing Plan are being followed. Specifically, the review examines how borrowers:

- Seek eligible tenants;
- Determine tenant eligibility;
- Determine the appropriate rent;
- Set up appropriate accounts; and
- Use initial operating capital

B. Key Areas Examined

The Loan Servicer examines the borrower's rent-up activities as detailed below.

- **Project records.** These include the actions that the borrower takes to attract qualified tenants, determine tenant eligibility, and determine correct rental rate. The project's management plan and Affirmative Fair Housing Market Plan contain the borrower's procedures for tenant selection and for determining the rental rate.

- **Tenant files.** The borrower must maintain files for each tenant. Tenant files must include such information as income verification, the lease, and documentation showing how tenant eligibility was established and how the rental rate was determined.

  To complete the review, the Loan Servicer will also need the project's waiting list (if applicable) and budget. These documents will be used to determine if the borrower is in compliance with the occupancy requirements set forth in Chapter 6 and the approved unit rental rates established in the project budget.

C. Timing

The post-occupancy review is conducted within 90 days after project operations begin or a transfer closes.

D. Key Staff

Loan Servicers perform the post-occupancy review.

E. Preparing for the Review

The Loan Servicer should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance exist by reviewing the borrower case file and MFIS.

- **Step 2.** Notify borrower, in writing, of upcoming review. The borrower should receive *Handbook Letter 202 (3560), Notification Letter for Supervisory Visit* at least 2 weeks prior to the review date to ensure that the necessary records and staff are available. Modify the letter as needed for the Post Occupancy Review. The borrower will, in turn, notify the tenants of the scheduled inspection.

- **Step 3.** Obtain the Multi-Family Housing Project Supervisory Visit form from MFIS.

F. Completing the Review

The Loan Servicer should use the worksheet for the Multi-Family Housing On-Site Review and the Worksheet for MFH Individual Tenant File Review portions of the Multi-Family Housing Project Supervisory Visit form for guidance. The borrower will have available the documentation requested by the staff member. The borrower may choose to be present during the review. The borrower's choice not to be present does not preclude the staff person from performing the review.

To complete the Post-Occupancy Review, the Loan Servicer must complete the following steps:

- Review the Management Plan and Affirmative Fair Housing Marketing Plan. This documentation is evidence that the borrower was aware of the procedures that were to be followed during initial rent-up.

  Review tenant files, waiting lists (if applicable), and budget. The tenant files reviewed should include a sample of accepted and rejected applicants.

  The reviewer must determine the following:

  ◊ If requested documentation is present and adequate to perform the review;

  ◊ Borrower's compliance with established procedures for marketing the project, qualifying tenants, determining rents, using waiting lists, and rejecting applicants.

- Summarize the occupancy review by completing the On-Site section of Part III of the Multi-Family Housing Project Supervisory Visit form.

G. Exit Conference

Conduct an exit interview with the borrower to discuss the results of the review, possible cause of deficiencies, and required solutions.

H. MFIS

Enter the results of the post-occupancy review in MFIS.

I. Follow-Up

If the review reveals deficiencies and/or compliance violations, prepare a letter to the borrower describing the deficiencies and a period for corrective action. If the borrower does not respond within the established timeframes, *Handbook Letter 301 (3560)*, as described in Chapter 10 of HB-3-3560, is to be sent within 15 days from the deadline initially given.

9.9 ANNUAL PHYSICAL INSPECTION

A. Purpose

Maintaining the physical condition of the secured property is the borrower's responsibility. The Agency Loan Servicers monitor the physical condition of the project to ensure that the property maintains its value and that tenants have housing that is decent, safe, and sanitary.

B. Key Areas Examined

The Loan Servicer will inspect the project's grounds, exteriors, common areas, and occupied and vacant units following the methodology described in Section 9.9 F. A full physical inspection must be performed when the results of this review indicate that the project is not being maintained in accordance with the physical standards for the program.

C. Timing

Annual inspections are required for all properties with outstanding physical findings identified in MFIS unless a full physical inspection and supervisory visit are due. However, the Loan Servicer may schedule an annual inspection at any time if warranted.

D. Key Staff

Trained and experienced Loan Servicing staff, assisted by the State Architect as needed performs the annual physical inspection. An experienced Loan Servicer should accompany inexperienced staff during their first two visits to the property.

State Officials are authorized at their discretion to accept third party inspection results for annual inspections. The borrower or the borrower's representatives (including tax credit syndicators) are not considered a third party for this purpose. Examples of acceptable third parties are Department of Housing and Urban Development (HUD), Freddie Mac, Fannie Mae, tax credit agencies and housing finance agencies. Loan Servicers must continue to populate MFIS with this inspection data.

E. Preparing for the Review

The Loan Servicer should complete the following steps before going to the project site to perform the review:

- **Step 1.** Determine if outstanding issues, areas of concern, or indicators of noncompliance with Agency requirements exist by reviewing the borrower case file, previous physical reviews, most recent inspection report, tenant complaints (if applicable), and MFIS.

- **Step 2.** Notify borrower, in writing, of up-coming inspection. The borrower must receive *Handbook Letter 202 (3560), Notification Letter for Supervisory Visit* at least 2 weeks prior to the review date to ensure that the necessary records and staff are available. Modify the letter as needed for the annual physical inspection. The borrower will, in turn, notify the tenants of the scheduled inspection.

- **Step 3.** Obtain the Multi-Family Housing Project Supervisory Visit form from MFIS.

F. Completing the Review

The Loan Servicer should use the Worksheet for MFH Exterior Physical Standards and the Worksheet for MFH Interior Physical Standards. The Loan Servicer will complete the following steps:

- Examine the project's grounds, exteriors, and common areas. The number of occupied units to be examined is the greater of 5 percent of all occupied units or at least two units. If the project has vacancies, the greater of 5 percent of vacant units or at least 2 vacant units must also be inspected. For example, a 48 unit project with 3 vacant units would require 2 occupied units and 2 vacant units to be inspected for a total of 4 units.

No. of Units to be Inspected Occupied Units + Vacant Units	
Occupied Units	Vacant Units
>5% or at least 2	>5% or at least 2

- Review the extent of borrower compliance with the physical accessibility requirements. Review the ability of the project's current budgeting and capital planning to implement any improvements identified by the borrower's transition plan. For information on transition plans, see Chapter 3.

- Complete all parts of *Form RD 3560-11, Multi-Family Housing Physical Inspection Report*.

- Photograph any deficiencies noted during the examination.

  Findings and Violations: The reviewer reports a finding or violation on *Form RD 3560-11* as those items that were previously identified as a deficiency or a weakness.

  A "finding" is a failure to meet physical standards that indicate a widespread occurrence or pattern of a physical problem that should be corrected through routine procedures.

  A "violation" is a finding that is elevated either by its severity or the Agency's inability to obtain a resolution from routine servicing methods. A violation should be recorded only if the Loan Servicer intends to pursue the problem through the three-servicing-letter process. Elevating a finding to a violation will have an effect on the classification.

- Conduct an exit conference with the borrower. The exit conference allows the borrower to ask questions and to prepare an appropriate response to the findings and/or violations noted in the report. In this meeting the Loan Servicer and the borrower can discuss the requirements and time frames for resolving each finding and/or violation. Identify any Health and Safety Issues, which must be resolved within 10 days.

G. MFIS

Enter the results of the annual physical inspection into MFIS.

H. Follow-Up

If the inspection reveals deficiencies or compliance violations, prepare a letter to the borrower describing the deficiencies and a period for corrective action. Issues of health and safety are to be resolved within 10 days. If the borrower does not respond within the established time frames, *Handbook Letter 301 (3560)* is to be sent within 15 days from the deadline initially given. The letter requires that health and safety issues be resolved within 10 days.

9.10 TRIENNIAL SUPERVISORY VISIT

A. Purpose

A Supervisory Visit consists of three components – a full physical inspection, an on-site review and a compliance review.

Adequate maintenance is a crucial element in providing housing that is decent, safe, and sanitary, and ensuring that environmental and accessibility requirements are met. The Agency regularly conducts full physical inspections of its properties to ensure that they meet established program standards.

The purpose of the on-site review component is to determine the borrower's continued compliance with the management requirements, financial requirements and occupancy requirements for the project. This review also includes an examination of unit rents to ensure that they are being charged in accordance with the approved budget.

The purpose of the compliance review is for Agency staff to review the borrower's compliance with the Affirmative Fair Housing Marketing Plan and/or the Equal Opportunity requirements of Title VI of the Civil Rights Act of 1964, the Civil Rights Act of 1968 as amended by the Fair Housing Amendments Act of 1988, Section 504 of the Rehabilitation Act of 1973, and the Age Discrimination Act of 1975.

B. Key Areas Examined

The Loan Servicer will inspect the project's grounds, exteriors, common areas, and a sample of dwelling units following the methodology described in Section 9.10 F.

The Loan Servicer reviews the borrower's occupancy procedures, rent charge calculations, the project's financial systems and controls, along with its maintenance and preventive maintenance programs.

When conducting a compliance review at a project and at the office of the borrower or management agent office, the Loan Servicer will focus on the following areas:

- Marketing procedures;
- Rental policies;
- Waiting list;
- Project and unit accessibility;
- Eviction policy; and
- Other operating policies, as relevant.

C. Timing

Supervisory Visits must be conducted at least once every 3 years, after the initial Post Occupancy Review, completed prior to the end of the fiscal year and should be conducted more frequently for projects with management that is unfamiliar with Agency requirements, or for projects experiencing occupancy or operational difficulties.

D. Key Staff

Trained and experienced field staff, assisted by the State Architect as needed, perform supervisory visits. An experienced Loan Servicer should accompany inexperienced staff during their first two visits to the property.

To conduct a compliance review, the Loan Servicer must go through training and obtain a special certification; therefore, only certified State Office or Field Office Loan Servicers can complete the Civil Rights and Fair Housing review requirements.

E. Preparing for the Supervisory Visit

The Loan Servicer should complete the following steps before going to the project site, or the office of the borrower or management agent to perform the Supervisory Visit:

- **Step 1.** Notify the borrower, in writing, of the upcoming Supervisory Visit. The borrower should receive Handbook Letter 202 (3560) "Notification Letter for Supervisory Visit," within 2 weeks of the visit to ensure the necessary records and staff is available. Since access to individual units will be required for inspection, the borrower or management agent must provide adequate notice to the tenants. If the Servicing Office chooses to do the tenant file review prior to the visit, request the files be sent at this time.

- **Step 2.** Obtain Multi-Family Housing Project Supervisory Visit form from MFIS.

- **Step 3.** Desk Review. Review MFIS and the borrower's case file to determine if outstanding issues, areas of concern, or indicators of noncompliance with Agency requirements and Civil Rights laws exist. The following documents should be included in this review:

  ◊ Physical inspection reports

  ◊ Tenants complaints (if applicable)

  ◊ Current Management Plan

  ◊ Borrower's operating regulations (e.g. grounds for eviction)

  ◊ Affirmative Fair Housing Marketing Plan

  ◊ Work Out Plan (if applicable)

◊ Quarterly/monthly reports

◊ Current Annual Budget

◊ Current Balance Sheet

◊ Current Notice of Payment Due Report

◊ MFIS Report FRM 2000 (Desk Review)

F. Completing the Review

Physical Inspection:

The Loan Servicer should use the Worksheet for MFH Exterior Physical Standards and the Worksheet for MFH Interior Physical Standards and Tenant Interviews portions of the Multi-Family Housing Project Supervisory Visit form from MFIS for guidance.

To complete the review, the Loan Servicer will:

- Examine the project's grounds, exteriors, common areas, and interior units. The number of units to be examined will be as follows:

Number of revenue producing units	Number of occupied units to be inspected
0-5 Units	All
6-30 Units	6 Units
31-74 Units	10 Units
75 or more Units	15 Units

Plus if the project has vacancies, the greater of 5 percent of vacant units or at least 2 vacant units must also be inspected. For example a 48 unit project with 3 vacant units would require 10 occupied units and 2 vacant units to be inspected for a total of 12 units.

- Complete all parts of the *Form RD 3560-11*.

- Review the extent of borrower compliance with the physical accessibility requirements of civil rights laws. Review the ability of the project's current budgeting and capital planning to implement any improvements identified by the borrower's transition plan.

- Photograph any deficiencies noted during the examination.

On-Site Review:

The Loan Servicer should complete the On-Site Review portion of the Multi-Family Housing Project Supervisory Visit form from MFIS.

To perform the on-site review, the Loan Servicer must complete the following steps:

- **Review project records** including marketing materials, applications, and waiting lists. The Loan Servicer should determine whether the marketing materials indicate that the project is complying with the Affirmative Fair Housing Marketing Plan. The Loan Servicer should also determine whether the applications and waiting list records indicate that the borrower is complying with tenant selection requirements.

- **Review tenant files,** which should include such information as income verifications, back-up documentation, the leases, and documentation showing how the rental rates were determined. The sample files should include accepted and rejected applicants. Use Worksheet for MFH Individual Tenant File Review portion of the Multi-Family Housing Project Supervisory Visit form from MFIS to record your review. MFIS will select tenant files using the File Selection Criteria defined below:

(a) MFIS will determine the number of files to be reviewed.

Number of revenue producing units	Number of files to be reviewed
0-5 Units	All
6-30 Units	6 Files
31-74 Units	10 Files
75 or more Units	15 Files

(b) MFIS will identify the risk factors.

Gross income < $3000
Medical Deductions
Initial Certification
Move-out
Eviction
Most recent recertification

(c) If there are an insufficient number of files using the risk factors then MFIS will randomly select the remaining files.

- For HUD Section 8 and Housing Choice vouchers, Tenant Subsidy Codes 2 & 6, a tenant file review is NOT required by the Agency.

The reviewer must determine whether:

◊ The borrower is maintaining adequate documentation; and

◊ The borrower is complying with program requirements for marketing the project, qualifying tenants, determining rents, using waiting lists, and rejecting applicants.

◊ If discrepancies are observed and determined to be trends in the tenant file reviews, a full review of all tenant files will be required within 90 days to determine further servicing such as collection of unauthorized assistance or obtain proper verifications.

- **Review borrower compliance** with management requirements, financial requirements and occupancy requirements for the project.

  The Loan Servicer will review the following:

  - Site Staff
  - Maintenance Systems
  - Capital Planning and cash flow
  - Cash Controls
  - Cost Controls
  - Insurance and Reserve Accounts
  - Identity of Interest
  - Occupancy Review
  - Tenant/Management Relations

  The Loan Servicer must complete the On-Site Review section of the Multi-Family Housing Project Supervisory Visit form.

Compliance Review:

To perform the compliance review, the Loan Servicer will:

- Review the management plan to determine project management's method of informing tenants and applicants regarding requests for reasonable accommodations.
- Review the lease agreement, application, and other documentation used by the borrower to determine if policies and procedures represent barriers to occupancy
- If a tenant is an ineligible occupant of a fully accessible unit, determine if there is an executed lease attachment that requires the tenant to move if an individual needing the handicapped features applies for occupancy
- Visually inspect the project to determine if there are physical barriers, and compare it to the self-evaluation and transition plan to determine if those barriers are addressed in the plan and are scheduled to be removed.

- Where transition plans are scheduled to remove barriers over more than a one-year period, review the transition plan and the most recently approved budget to ensure that borrower budgeting and the project's financial condition is supportive of the transition plan as written. Transition plans should include the potential cost of removing identified barriers.

- Interview tenants to determine if the borrower has provided information and made reasonable accommodations upon request by the tenant

- Interview tenants in the fully accessible units to determine if the tenant has need of the accessibility features of the unit and is an eligible occupant

G. Exit Conference

Upon completing the supervisory visit, the Loan Servicer should conduct an exit conference with the borrower to address findings, cause of findings, and possible resolutions. Advise borrower of any Health and Safety Issues, which must be addressed within 10 days.

H. MFIS

Enter the results of the inspection into MFIS.

I. Borrower Notification of Review Results

The Loan Servicer must prepare a written description of the review results for the project case file. They must also issue a letter to the borrower summarizing the conclusions of the supervisory visit and indicate specific follow-up actions the borrower is required to take. In addition, the results of the supervisory visit should be forwarded to other RD offices working with this borrower or agent.

This letter is sent to the borrower within 30 days of the supervisory visit. This letter requests the borrower to respond with procedures and time frames for correcting the noted deficiencies within 30 days. However, if the noted findings involve issues of health and safety, the borrower is required to resolve those specific issues within 10 days of the letter.

If the results of a physical inspection indicate a finding or violation pertaining to "Common Area Accessibility," "Fully Accessible Units," or other relevant physical or accessibility standards, the Loan Servicer should include the specific language in communications with the borrower as shown in Exhibit 9-4.

Exhibit 9-4
Sample Language – Civil Rights Violations Detected During Physical Inspections

"Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued noncompliance may result in your ineligibility to receive further loan funds from the Agency. You failed to meet the following MFH physical standard(s):

1. Common Area Accessibility (Specify)
2. Fully Accessible Units (Specify)
3. Other (Specify)."

If the results of the supervisory visit indicate noncompliance with other Civil Rights laws the Loan Servicer should also include the specific language regarding noncompliance as shown in Exhibit 9-5.

Exhibit 9-5

Sample Language to Use When Compliance Reviews Uncover Violations to Civil Rights Laws

"Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued noncompliance may result in your ineligibility to receive further loan funds from the Agency. You are in noncompliance with the following: (Specify)."

J. Follow Up

If the borrower does not respond within the established timeframes, Handbook Letter 301 (3560) in Chapter 10 of HB-3-3560 is to be sent to the borrower within 15 days from the deadlines initially given.

If a third party is involved in financing or providing subsidy to the property and a formal arrangement exists with this third party, the Agency will provide a copy of the notice to the third party source to share information concerning the Agency's findings.

Servicing Offices must notify the State Civil Rights Coordinator/Manager (SCRC/M) if borrowers fail to bring themselves into compliance with Civil Rights Laws or fail to submit an acceptable transition plan. The State Director will forward the issue of noncompliance to the National Office Civil Rights Staff. The National Office Civil Rights Staff will notify the State Director if further review and processing of the finding will either resolve the finding or require that it be forwarded to the National Office Civil Rights Staff or the Justice Department to resolve the noncompliance issue. The SCRC/M will notify the State Office and the Servicing Office of the disposition of the finding of noncompliance. The SCRC/M will notify the State Office and the Servicing Office of the disposition of the finding of noncompliance.

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SECTION 3: AGENCY MONITORING FOR LABOR HOUSING PROJECTS

9.11 OFF-FARM LABOR HOUSING

Off-Farm Labor Housing projects should be monitored in accordance with the requirements established in this chapter for other multi-family housing projects.

9.12 ON-FARM LABOR HOUSING

On-Farm Labor Housing projects should be reviewed by the Agency at least once every three years. The Loan Servicer should complete the Supervisory Visit Worksheets from MFIS. During the monitoring visit, Loan Servicers should review:

A. Eligibility Documentation

Borrowers should properly document that each resident is eligible to live in the On-Farm Labor Housing unit. At a minimum the borrower should have an executed lease or employment contract with each tenant and each tenant should meet the eligibility requirements established for On-Farm Labor Housing tenants in Section 9 of Chapter 6 of this Handbook.

B. Financial Information

The borrower must document that the on-farm labor housing unit(s) are being operating in a nonprofit manner. At a minimum the borrower should develop an operating budget that demonstrates revenues equal expenses and the borrower is not receiving a return from the property.

C. Operating Plan

The review of the operating plan should also ensure that the property is being managed in a nonprofit manner and that tenant requests and grievances are being handled in a timely manner and in accordance with the management plan.

D. Loan Agreement

The review of the loan agreement should ensure that the borrower is in compliance with the agreement made to the Agency to provide adequate housing to the employees in the borrower's employment and not to charge rent, unless otherwise approved by the Agency.

E. Security Deposits

If the borrower has charged security deposits to the tenants, then the review should ensure that security deposits are being managed in accordance with state and/or local law.

F. Payment of Taxes and Insurance

The review of taxes and insurance should ensure that taxes are being paid in a timely manner and at the very minimum to ensure that the borrower has adequate insurance in place to cover replacement of the property in the event of a loss.

SECTION 4: STATE OFFICE OVERSIGHT OF SERVICING ACTIVITIES

Once the Servicing Office has conducted routine oversight and reviewed its portfolio, the State Office has a responsibility for additional oversight in a broad sense. The goals and responsibilities of State Offices are described below.

The State Office must use MFIS as the database for maintaining and analyzing project financial information as well as recording and tracking project supervisory activity and servicing efforts.

9.13 PORTFOLIO MANAGEMENT GOALS

Proper asset management of the Agency's multi-family housing portfolio begins with a thorough evaluation of the entire portfolio to obtain a clear understanding of existing and potential problems. Close monitoring, timely follow-up, and a consistent administration of the regulations will be beneficial in the resolution of problems and will contribute to the stability of the program.

Staff, at all levels, need to be to be better prepared to address the challenges relating to their portfolio. Staff must be provided with training, resources, and support to meet these challenges. The mission and goals, and plan of action for effective loan servicing and portfolio management are described below. For tracking adherence to these goals, State Offices should look at the appropriate MFIS or AMAS report unless specified otherwise.

1.* <u>RECEIVERSHIP PROPERTIES</u>*. Reduce Receivership Periods to No More Than 12 Months

(Measurement Tool: MFIS TRK 2000 – Servicing Effort Tracking Report)

The oversight process of a property held in receivership by the Agency requires close monitoring and supervision by the National Office, State Office, and Servicing Office. This will include the review of property financial records such as monthly reports, year-end reports, and annual audits. Additionally, the staff is responsible for review and approval of the payment of certain expenses, such as management fee, taxes and insurance.

Receivership properties may have special needs and may need to be serviced within the parameters of a workout plan. Others will require sales and/or other liquidation plans. To transition out of the receivership, it will be necessary to focus efforts on obtaining new substitute general partners, transfers of ownership, or to liquidate accounts.

States should input servicing data into the comment section of MFIS to provide updated status.

2.* INVENTORY PROPERTIES*: Reduce Inventory Property Holding Periods to No More Than 12 Months

(Measurement Tool: States will input comments to update the status of inventory properties in MFIS on a monthly basis. The National Office will review the status of inventory properties by compiling AMAS Reports and then reviewing MFIS TRK 2000.)

State Offices must review their inventory property portfolio and take necessary actions to effectively dispose of these properties. To accomplish this, all efforts should be given to marketing the properties, including reducing the price, sealed bids, or sale as a non-program property. All inventory properties should be managed and made ready for sale in the most expeditious manner using the authorities in 7 CFR part 3560, subpart K.

The National Office should be contacted for assistance in the sale of a property experiencing marketing difficulties.

3. DELINQUENT LOANS: ***Maintain a Delinquency Rate of Two Percent or Less***

(Measurement Tool: AMAS RC 545 Report)

All states with delinquency rates that exceed two percent are required to work with borrowers and take appropriate servicing actions to reduce their delinquency rates to two percent or less.

Borrowers who are consistently delinquent require aggressive servicing and counseling regarding late payments. If long-term delinquency is the result of pending litigation for liquidation, appropriate officials should be notified and encouraged to expedite such litigation. When states are experiencing difficulties with litigation officials or when the loan is part of a long-term work-out agreement, the National Office should be contacted for assistance.

A number of long-term delinquencies are the result of inactive accounts with loan balances remaining after the asset is liquidated (i.e., foreclosure, sale, or transfer for less than the debt, compromise offer, bankruptcy, etc.). These accounts need to be settled due to their negative impact on the overall multi-family housing delinquency rate. State Offices are to immediately request assistance of OGC, the Assistant U.S. Attorney, and/or the National Office when accounts in this category are determined to exist.

Any state with average delinquency rates above the two percent national average will be closely monitored and contacted by the National Office to determine what efforts are being made to reduce the delinquency, and to identify whether assistance or training is needed. Delinquency status reports may be required from those states identified as having problems. Similarly, any states exhibiting a trend in increasing delinquencies may be required to submit an explanation or a plan of action. Any instances of Servicing Offices holding payments and not processing them in a timely manner must be discontinued immediately. All payments are to be processed when received.

4. <u>OPERATING BUDGETS/UTILITY ALLOWANCES</u>: *Take Appropriate Action on All Budgets/ Utility Allowances Prior to the Beginning of a Project's Fiscal Year*

(Measurement Tool: MFIS TRK 3000 – Tracking Step Summary Report)

Budgets are to be reviewed and approved on MFIS prior to the start of the borrower's fiscal year. If not received or if unacceptable, a finding and a follow up date must be entered in MFIS. Loan Servicers must take action on all budgets within 60 days of receipt.

5.* <u>ANNUAL FINANCIAL REVIEWS</u>*: Complete All Year-End Financial Reviews Within the Required Time Frame

(Measurement Tool*:* MFIS TRK 3000 – Tracking Step Summary Report)

The "Actuals" listed on *Form RD 3560-7* and *Form RD 3560-10,* and the engagement are to be reviewed and any findings entered on MFIS within <u>60 days</u> of receipt. The borrower is to be notified of the results of the review and MFIS is to be updated accordingly. If financial information is not received or is unacceptable, a finding and a follow-up date must be entered in MFIS.

6. <u>ANNUAL PHYSICAL INSPECTIONS</u>: *Complete All Required Annual Physical Inspections.*

(Measurement Tool: MFIS TRK 3000 – Tracking Step Summary Report)

The purpose of the annual physical inspection is to determine whether or not there are problems that may require immediate attention. In addition, a determination should be made if the exterior and common areas are accessible as required by applicable Federal law. All findings and follow-ups must be entered into MFIS.

7. <u>SUPERVISORY VISITS</u>: *Complete All Required Supervisory Visits and Compliance Reviews.*

(Measurement Tool: MFIS TRK 3000 – Tracking Step Summary Report)

The Supervisory Visit is the Agency's primary tool to complete in-depth analysis of the borrower operations with regard to Management Plan/Agreement, Fair Housing, tenant eligibility, file review, budget compliance, building security and maintenance. The borrower is to be notified of findings and deficiencies and given a timetable to correct all problems. Any summary level findings must be entered into MFIS.

8. **<u>STATE OFFICE OVERSIGHT OF MFIS DATA</u>:** ***State Office responsibility is to select and review 5 percent of projects receiving the Supervisory Visit during the year and to ensure that all the data elements in MFIS have been input.***

State Office staff must continuously monitor supervisory activities and borrower status to ensure that each project is receiving timely and effective supervision. MFIS will be used to accomplish these monitoring responsibilities.

When used correctly, MFIS enables the Agency to effectively manage the multi-family housing portfolio and ensure the proper use of Federal housing resources. Staff at National, State, and Servicing Office levels has immediate access to portfolio information in order to make better program management decisions, and more effectively deploy limited resources. With the implementation of MFIS, the ability to review portfolio activity now extends to borrowers and management agents as well as servicing office jurisdictions.

State and Servicing Offices are required to input the current status of all servicing actions into MFIS. The State Office must monitor the MFIS activities of Servicing Offices to ensure that data are accurate, consistent, timely, and complete and that regulatory authorities are effectively used to manage the portfolio and determine that Agency resources are effectively used to obtain compliance.

At least quarterly, State Offices must print out and review the MFIS project classification report. For projects classified with a D or C, State Offices must review the project's supervisory and servicing status on MFIS.

National Office will issue monthly reports on status of portfolio and semi-annual reports on the state's accomplishment on servicing goals.

SECTION 5: NATIONAL OFFICE INITIATIVES AND OVERSIGHT

9.14 WAGE AND BENEFIT MATCHING

States are required to obtain wage and benefit matching agreements with State Departments of Labor (SDOL) and to fully implement and utilize income matching of tenants applying for assistance and rental subsidies under the Multi-Family Housing programs.

State Office staff will:

- Execute a Memorandum of Understanding (MOU) or other appropriate agreement with the state agency charged with administering information required to be kept by the US Department of Labor (DOL) on wage earnings and benefits. The purpose of the MOU is to improve the controls over income certifications and subsidy payment accuracy by providing an independent source for verifying incomes of participants. Before entering into such agreements, states are reminded that the advice and consent of the Office of the General Counsel (OGC) must be obtained.

- Aggressively pursue implementation of MOUs. If assistance is needed to overcome implementation barriers such as statutory prohibitions, automation issues, or a lack of cooperation from the state agency, the Deputy Administrator for Multi-Family Housing Programs should be contacted.

- Approve computer-matching arrangements. The administrative oversight required for a fully interactive wage and benefit-matching system involves considerable resources to meet the stringent administrative oversight required by law.

    1. Where two or more Agency automated systems are to be linked to merge data, the advice and consent of the Deputy Administrator, Multi-Family Housing must be obtained prior to implementation of such a system. (Example: Rural Development may arrange to access a State Wage and Benefit Information Collection Agency's database and pull up information on Agency hardware platforms. Rural Development can then manually compare the results on computer screen or printout with Agency data.)

    2. When the data from two or more agencies is being merged to facilitate efficient comparison between incomes and benefits reported via use of automated software routines comparing database records, approval by the Department of Agriculture's Data Integrity Board is required. In addition, publication of the action in the Federal Register and notification to Congress is required.

- Determine when and how often to conduct wage and benefit matches. State Offices will establish routines to require and ensure that wage matches are performed each year on at least 10 percent of all initial and subsequent tenant certifications of those households earning income, for those residents scheduled to be interviewed prior to conducting supervisory visits, and for projects where the supervisory visits reveal significant discrepancies. (Normally, wage and benefit matches will not exceed a 20 percent level.)

Other incidences when wage and benefit matches may be obtained, but are not required, are for tenant households who are moving into projects for the first time, for tenants or applicants claiming zero or unreasonably low incomes, and for existing tenants where the management agent or the servicing official deems wage matching appropriate.

- Wage and benefit matching for MFH programs includes Labor Housing residents whose eligibility or receipt of subsidy is determined in whole or in part on wage and benefit data.

- Establish notification routines for initiating MFH wage and benefit matching. States may use the notices to borrowers, management agents, and residents, set out in **Appendix 4** of this Handbook, as guides in implementing the wage and benefit matching system for MFH programs.

- Identify illegal or improper assistance and service suspected or confirmed abuses in the MFH program. If the DOL verification and investigation reveals that a tenant has submitted inaccurate or false information regarding household income, the servicing staff is required to notify the borrower of the findings. The borrower must attempt to correct the tenant certification and/or seek restitution of any improperly received rental assistance. See **Appendix 4** of this Chapter for guidance in notifying the borrower of any discrepancies discovered. The borrower will provide the tenant a notice of lease violation and an opportunity for repayment. If the tenant refuses or is unable to repay, the borrower will initiate eviction proceedings. If the tenant moves out of the unit without repaying, the borrower will provide the Agency all relevant tenant records so the Agency can begin the process of recouping the improper assistance through the use of US Treasury offsets

  State Offices can contact the Deputy Chief Financial Office, Program Reporting Branch of the St. Louis Office to request assistance in further servicing and collection processing.

- The Agency will confirm that the benefits received under the current tenant certification period are accurate. The Agency does not intend to require past tenant certifications to be reviewed for accuracy by wage and benefit matching unless there is evidence of substantial abuse and the amount of the past-unauthorized assistance exceeds $500. In addition, any recovery efforts must not begin without first having been assured that tenants have had the opportunity to review the accuracy of the information and appeal any disagreements in accordance with the provisions of CFR 3560.160.

Report Quarterly to the National Office on State's progress in obtaining MOUs.

States listed in **Attachment 9-A** that do not have MOUs in place (except those where State Law prohibits wage matching) must submit quarterly progress reports on actions taken to implement an MOU by memorandum or e-mail to the National Office, Multi-Family Housing Portfolio Management Division (MFHPMD).

9.15 UNUSED RENTAL ASSISTANCE

It is the intent of the National Office to recapture all available unused rental assistance into an Administrator's Rental Assistance (RA) Reserve account. This account will be used at the Administrator's discretion. The intent behind establishment of the Reserve is maximum utilization of available RA. State Directors are responsible for identifying unused RA, establishing when unused RA should be withheld from the Administrator's Reserve pending specific events, and how unused RA held in reserve will be transferred according to priorities established by the Administrator. The effective use of Rental Assistance is a major goal of Rural Development.

A. Unused Rental Assistance Reports

State Directors must report semi-annually on the status of the RA units unused for 6 months or more in their State using **Attachment 9-B**, "Report of Status of Unused RA units." The basis for this information comes from MFIS Report PRJS 4200, "Occupancy Trend." In addition to vacancies, the report identifies unused RA units as of the 1st day of the reporting period.

When identifying RA units being unused for six months, evaluations need to be made to determine if RA units are unused because of tenant turnover. This is particularly true in the case of one or two RA units appearing eligible for possible transfer. MFIS Report PRJS 4200, "Occupancy Trend" identifies the possible number of RA units available for transfer. This number is the fewest unused RA units for the past six month period. A review of the current month's occupancy is necessary to determine if there are any applicants/tenants who may need the RA unit in the next month.

A review of MFIS Report PRJ2000, "Project Worksheet" and PRJS 4200, "Occupancy Trend" is needed to determine the impact of unused RA by the following situations:

1. Tenants vacating
2. Tenants moving in
3. Tenants paying overage
4. Percentage of occupancy
5. Number of vacant units

After the review and analysis of the reports, the property should be contacted if there is any uncertainty about the cause of the RA unit being unused.

Regulation 3560.257(c) requires that "…borrowers must assign available rental assistance units as soon as…units become available". If there is substantial traffic in and out of the property, analyze closely to see if the RA that was unused was again re-used in subsequent months within the 6-month period.

Pay particular attention to this in cases where there is substantial activity and one or two units are identified as unused. This is the effect of "turnover": RA can appear to be unused where there is substantial tenant traffic, when in fact it may be an overlap of unused RA units.

- Part A – Unused RA and unused RA withheld from the Administrator's Reserve to be used within the next 6 months. All units identified as available for the Administrator's Reserve should be immediately available for transfer upon submission of the report.

- Part B – Properties where Unused RA is intended to be used in Part A. States must identify the proposed disposition of unused RA according to categories listed in the Report and the following guidance below:

- Part C – State Director's intended use from the Administrator's Reserve.

Reports are due no later than 30 days after April and October (e.g. the Status Report as of April 1 is due May 1).

B. Evaluation of Report

The National Office will review the Status report within 30 days of receipt. If the National Office determines that State Offices are not aggressively utilizing the unused RA, the Administrator may determine the placement of unused RA units, including transfer to rent overburdened tenants or to the Administrator's RA Reserve account. If units are to be transferred to the Reserve, the National Office will advise the State Office so that all required administrative actions can be undertaken to affect the transfer. If unused units will not be transferred to the Reserve, the National Office will advise the State Office so that all unused units can be effectively utilized.

SECTION 6: SPECIAL PROCEDURES FOR DECLARED DISASTERS

In the event of a natural or man-made disaster declared by the President of the United States, the Agency may authorize certain actions to be undertaken or certain regulatory provisions that may be waived for MFH borrowers who make their housing available for disaster evacuees.

9.16 PRESIDENTIALLY-DECLARED DISASTERS

In the event of a disaster, the Federal Emergency Management Agency (FEMA) identifies counties affected by the disaster and makes available money or direct assistance to individuals whose property has been damaged or destroyed and whose losses are not covered by insurance.

The Agency has developed Special Actions and Waivers that may be implemented in the event of such disasters for tenants who are residents of the affected counties and owners of Rural Development-financed properties located in the affected counties. For disasters that impact at least 500,000 people, special disaster-related Servicing Actions will be put into effect as outlined below.

A. Definition of Evacuees

For purposes of the Section 515 and Section 514 loan programs, “disaster evacuees” are defined as residents of counties included in the declared disaster area identified by FEMA. In order to qualify as a recipient of Rural Development multi-family housing assistance and receive the benefits identified below (Special Actions and Waivers), a disaster evacuee must present evidence to the property manager of having resided in the affected county. This evidence may be a driver’s license, utility bill, mortgage statement, lease, etc., or the property manager may verify the address, date of birth etc., from a credit agency.

By definition, a resident in a Rural Development financed property located in a disaster county is a “disaster evacuee” and may be entitled to benefits from Special Actions identified below. For example, an existing tenant may suffer a job loss due to the disaster, which could result in receipt of emergency rent assistance provided by another governmental agency.

B. Use of Rural Development Rental Assistance Program

A disaster evacuee who is receiving rent assistance from any governmental agency is not eligible to receive benefits from the Rural Development Rental Assistance Program. If the evacuee is not receiving rent assistance from another government agency, the property manager should apply the standard eligibility tests for the evacuee to receive Rural Development Rental Assistance. If the manager is unable to obtain verifications of income or employment because of the disaster, no Rental Assistance can be provided.

9.17 SPECIAL ACTIONS AND WAIVERS

Regardless of the size of the affected population, State Directors have authority to implement the following procedures without National Office approval:

1. Applicants may receive a Letter of Priority Entitlement (LOPE) issued by USDA Rural Development or may provide the property owners with documentation of being registered with the FEMA in lieu of a LOPE letter.
2. If an applicant does rent a Rural Development-financed property, the FEMA registration number must be entered into Multi-Family Information System (MFIS). Within *90 days*, field staff will need to conduct a random sampling of tenant files to assure that the FEMA data was input into MFIS correctly.
3. Allow for imputed income from assets due to homeownership affected by the disaster.
4. Zero income applicants will be allowed to reside in apartment units; rental assistance (if available) will be made available to the applicant.
5. Collection of security deposit per 7 CFR 3560.204 may be waived, if requested by the owner of the property.
6. Owners of elderly designated properties may rent to age ineligible applicants for *6 months* from the date of the State Director decision.
7. Annual lease required per 7 CFR 3560.156 (b)(2) is waived and leases may be issued on a month-to-month basis.

Special Actions and Waivers that may be provided by the Agency and the Servicing Requirements that must be implemented by Servicing Officials are listed below.

A. Tenants Displaced from Rural Development Financed Multi-family Properties

For existing MFH tenants or Section 502/504 borrowers displaced by the disaster, the Agency has several authorities available to minimize the impact of the devastation.

Special Action	**Servicing Requirements**
1. The existing MFH tenants and/or Section 502/504 borrowers made homeless by the disaster may apply for occupancy at any Rural Development financed property as a "displaced tenant." In accordance with 7 CFR 3560.154 (g)(2)(ii), they will be placed, first come-first served, on the waiting list, with or without a Letter of Priority Entitlement (LOPE letter). They would then be offered any vacant unit or the next available unit if no vacancies exist. Under this circumstance, the tenant required to move is entitled to or could benefit from the special actions and waivers identified in this section.	No action required.

Special Action	**Servicing Requirements**
2. Some existing tenants may have been receiving Rental Assistance (RA) in units made uninhabitable by the disaster. While the Agency cannot provide RA to a tenant unless they occupy an eligible Rural Development financed property, the Agency can allow the transfer of the tenant's RA unit to an eligible Rural Development property where the tenant could then continue to receive RA. Any such arrangement needs to be agreed to by all parties and be designed to return the RA, and the tenant if they chose, back to their original apartment unit.	In accordance with this special action, Servicing Officials will be authorized to arrange temporary transfers of RA from properties made uninhabitable by the disaster to properties in surrounding areas that have vacancies in habitable units, as follows: a. The owners must enter into an agreement whereby RA units, in an amount equal to or less than the number of vacant units in the receiving property, are transferred for a period of time until the units in the damaged property can be made habitable. When the units are habitable, the RA units will be transferred back to the original property. RA units may be transferred as a group or one at a time. b. First priority for the use of transferred units is RA tenants moving from the damaged property. The tenants would be accommodated first come-first served from the waiting list in accordance with 7 CFR 3560.154 (g)(2)(ii). These displaced tenants would receive priority over any other applicant or existing tenant. c. Displaced tenants receiving the transferred RA must sign an attachment to their lease indicating that they understand that the RA unit will be returned to its original property when the damaged apartment unit has been made habitable. At that time, the displaced tenant could also return and continue to receive RA. This agreement would be subject to the tenant remaining eligible and the tenant wishing to return to their original unit. However, if the tenant chooses to stay, they could not be assured RA and the borrower would charge an appropriate rent based on any subsidy available to that property.

B. Assistance for Rural Development Financed Properties Destroyed or Damaged

In properties where all or a substantial number of the units become uninhabitable, the Agency has several authorities available to minimize the financial impact of the disaster.

Special Action	Servicing Requirements
1. If borrowers are unable to transmit tenant certification information due to communication problems relating to the disaster, the Agency may waive overage charges due to late submission. The borrower should contact the Servicing Office to advise them of any problems with transmitting information to the Agency.	State Office may waive overage charges.
2. If borrowers are temporarily unable to make loan payments, the Agency may waive late fees to reduce any extra financial burden.	State Office may waive late fees.
3. The Agency may enter into servicing workout plans to assist properties whose financial viability has been disrupted. Workout plans as described in 7 CFR 3560.453 can include a variety of actions to lower operating costs. These include reducing contributions to the reserve account or lowering loan payments. Reamortization of the account can be used to bring the account current once the repair is completed. Servicing workout plans would also bring into consideration any borrower receipt of insurance benefits.	The Agency should work with the Borrower to determine an appropriate workout plan.
4. Provided borrowers are making a good faith effort to repair any apartment units made uninhabitable by the disaster, interest credit may remain in effect.	The Agency should review the situation after 180 days to assess progress in rehabilitating damaged units.

C. Non-Rural Development Tenants

Disaster evacuees who were not tenants in other Rural Development properties may apply for housing in Rural Development financed properties. Evacuees are entitled to receive a LOPE letter or may have a FEMA registration number, both of which place them at the top of the waiting list. Borrowers, at their discretion, may apply or waive their standard tenant screening requirements. Borrowers must, however, continue to comply with all Fair Housing regulations and the selection criteria cannot be arbitrary or discriminatory.

Special Action	**Servicing Requirements**
1. Borrowers who house disaster evacuees are required to utilize tracking identification numbers of other government agencies if the evacuee has received federal disaster assistance. If a disaster evacuee applicant rents in a Rural Development-financed property, the FEMA registration number must be entered into Multi-Family Information System (MFIS).	In disaster situations where more than 500,000 people are affected, Agency officials should ensure that: 1. The property manager inquires about and obtains verification of receipt by an evacuee of any rent assistance provided by any governmental Agency, such as Transition Housing Assistance offered by FEMA. If such assistance is received in a lump sum, it will be treated as exempt income for rent calculation purposes. If such assistance is regular and on-going, the assistance will be counted as income, *regardless of the size of the disaster*. These amounts should appear on the Tenant Certification, Form RD 3560-8; 2. If a tenant receives a rental voucher (similar to a HUD voucher), then the property manager should code Form RD 3560-8, Part II, field 6 "Tenant Subsidy Code" as "4 – Other Public RA." 3. Managers must obtain such verification within 90 days of occupancy; 4. Borrowers must place in the tenant's file a copy of the FEMA award notification or other corroborating evidence that the tenant is registered to receive benefits from FEMA; 5. Managers must indicate on the Tenant Certification the appropriate disaster code (as provided by Rural Development) for each evacuee housed in the property. Managers must include the correct FEMA registration number on the Tenant Certification form. 6. Servicing Officials must conduct a random sampling of evacuee files within 90 days of occupancy to assure that the evacuee provided all required certifications, that the FEMA and the correct disaster code was input to MFIS correctly, and follow-up with corrective actions within 30 days; 7. Borrowers should notify disaster evacuees of any available emergency Rural Development assistance upon notification from Rural Development;

Special Action	**Servicing Requirements**
	8. Servicing Officials must conduct a random sampling of evacuee files within 180 days to review rent charges to all evacuees to ensure borrowers are not collecting rent amounts in excess of the tenant's net tenant contribution and review properties that have an unusually high number of tenants classified as disaster evacuees (in cases where emergency rental assistance has been provided).
2. Allow for imputed income from assets due to homeownership affected by the disaster.	
3. Zero income applicants may be allowed to reside in apartment units, if rental assistance or other subsidy is available.	
4. Collection of security deposit per 7 CFR 3560.204 may be waived, if requested by the owner of the property.	
5. Owners of elderly designated properties may rent to age-ineligible applicants for six months from the date of the waiver.	In disaster situations regardless of the number of people affected, Servicing Officials must review a random sample of evacuee files within 180 days of evacuee occupancy to ensure that the age-ineligible evacuees are no longer residents of the elderly designated properties.
6. If requested, the Agency may waive 7 CFR 3560.576 (b)(2) and (e) to allow Off Farm Labor Housing owners to accept non-farm applicants and allow for income to be received from sources other than from farm labor employment.	In disaster situations regardless of the number of people affected, Servicing Officials must review a random sample of evacuee files within 180 days of evacuee occupancy to ensure that the ineligible evacuees are no longer residents of the farm labor housing property.
7. Annual lease required per 7 CFR 3560.156 (b)(2) may be waived and leases may be issued on a month-to-month basis.	

ATTACHMENT 9-A

State Wage and Benefit Matching Agreements

(As of April 2006)

State	Matching Agreements	Matching Impediment	Actively Matching	Disclosure Allowed
Alabama	Yes	N/A	Yes	Yes
Alaska	Yes	N/A	No	No
Arizona	Yes	N/A	Yes	Yes
Arkansas	No	C	N/A	N/A
California	Yes	N/A	Yes	No
Colorado	Yes	N/A	Yes	No
Connecticut	No	B	N/A	N/A
Delaware	Yes	N/A	Yes	No
Florida	Yes	N/A	Yes	Yes
Georgia	Yes	N/A	Yes	Yes
Hawaii	No	C	No	No
Idaho	Yes	N/A	Yes	Yes
Illinois	Yes	N/A	Yes	No
Indiana	Yes	N/A	Yes	No
Iowa	Yes	N/A	Yes	No
Kansas	Yes	N/A	Yes	No
Kentucky	No	B	N/A	N/A
Louisiana	Yes	N/A	Yes	No
Maine	Yes	N/A	Yes	No
Maryland	Yes	N/A	Yes	No
Massachusetts	No	A	N/A	N/A
Michigan	No	A	N/A	N/A
Minnesota	Yes	N/A	Yes	No
Mississippi	No	C	N/A	N/A
Missouri	Yes	N/A	Yes	No
Montana	Yes	N/A	Yes	N/A
Nebraska	Yes	N/A	Yes	No
Nevada	Yes	N/A	No	No
New Hampshire	No	A	N/A	N/A
New Jersey	Yes	N/A	Yes	No
New Mexico	No	C	N/A	N/A
New York	No	C	N/A	N/A
North Carolina	Yes	N/A	Yes	N/A
North Dakota	No	A	N/A	N/A
Ohio	No	A	N/A	N/A
Oklahoma	No	A	N/A	N/A
Oregon	Yes	N/A	Yes	No
Pennsylvania	No	C	N/A	N/A
Puerto Rico	No	A	N/A	N/A
Rhode Island	No	A	N/A	N/A
South Carolina	No	C	N/A	N/A
South Dakota	Yes	N/A	Yes	No
Tennessee	Yes	N/A	No	No

State	Matching Agreements	Matching Impediment	Actively Matching	Disclosure Allowed
Texas	Yes	N/A	Yes	No
Utah	Yes	N/A	Yes	No
Vermont	No	C	N/A	N/A
Virginia	Yes	N/A	Yes	No
Washington	Yes	N/A	Yes	No
West Virginia	Yes	N/A	Yes	No
Wisconsin	Yes	N/A	Yes	Yes
Wyoming	Yes	N/A	Yes	No

A = State Law prohibited agreement
B = RD State Office could not reach acceptable agreement with State DOL
C = RD State Office working with State DOL to reach an acceptable agreement. Quarterly reporting as to the status of reaching an acceptable agreement to the National Office is required.

ATTACHMENT 9-B
REPORT OF STATUS OF UNUSED RENTAL ASSISTANCE UNITS

State:_____

Use this form to report semi-annually on the planned disposition of available unused RA in your State. In the table below, identify the number of withheld units allotted in each category.

Check the box below for the appropriate Reporting Date:

A. ☐ Reporting as of April 1, 20____ Due Date: May 1, 20__
B. ☐ Reporting as of October 1, 20 ___ Due Date: November 1, 20__

Part A	# RA units	
1. Possible RA Units for Transfer: (Per PRJS4200 "Occupancy Trend")		☐ **If adjusted for turnover units, check this box.**
2. Less: LH Seasonal – units not currently occupied		
3. Less: Legal Actions Underway (Acceleration/Foreclosure)		
4. Less: Property Undergoing Rehab. – units not currently occupied		
5. Less: Existing RA Agreement dated prior to 5/85 (Agreement does not allow for transfer)		
6. Less: Unused RA Units Currently in Appeal		
7. Less: Unused RA units to be used in conjunction with new construction/ rehabilitation/ ownership transfers/equity loans		**Complete Part B for all RA units identified on this line**
8. Less: No. of RA units that have not begun to go through the administrative actions (appeal rights)		
9. Administrator's Reserve		**Line 2 minus the sum of lines 3 through 9.** **Must submit Form RD 3560-55 (only complete the "Transferor" column) for all projects with units on this line. If RA units are from FY 2004 – 2006 appropriations, please provide expiration date on Form RD 3560-55 in the Remarks section.**

_____

(Signature) State Director Date

Part B: States must identify the Proposed Disposition of their available unused RA. State Directors may designate unused RA units to be used in conjunction with new construction, rehabilitation, transfers, or incentive loans that are expected to be used in the next 6 months. Units should be used within the allotted timeframe or will become subject to recapture. **Number of RA units listed must match Part A, line 8.**

Project Name	No. of RA units	Date of Anticipated Use	Purpose (I.E. New Construction, Rehabilitation, Transfers, Equity Loans)

Part C: This is your State's Request for Unused RA that may be available from the Administrator's Reserve. Use the codes below and identify State needs for RA. Do not repeat property needs from Part B unless there is insufficient unused RA in your State to satisfy the project's needs.

Use Code (See Below)	Project Name	No. of RA units	Date of Anticipated Use	Comments

Use Codes:

1. National Emergency – Per Administrator's declaration

2. State Emergency – Per State Director declaration and National Office concurrence

3. Preservation – Sale to Nonprofit or Incentive RA (to be used within the quarter)

4. Agency Credit Sales (to be funded in current FY)

5. Ownership Transfer (to close within the quarter)

6. Agency Rehabilitation loan (to be used within the quarter)

7. Other Rehabilitation funding (to close within the quarter)

8. New Construction (to be used within the quarter)

9. Workout Plan (To be used within the quarter)

10. Rent Overburdened Tenants

11. Other (identify in Comment area)

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Appendix 1

7 CFR PART 3560--DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS

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7 CFR Part 3560

7 CFR PART 3560 – DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS

Subpart A--General Provisions and Definitions

§3560.1 Applicability and purpose.

(a) This part sets forth requirements, policies, and procedures for multi-family housing (MFH) direct loan and grant programs to serve eligible very-low, low- and moderate-income households. The programs covered by this part are authorized by title V of the Housing Act of 1949 and are:

(1) Section 515 Rural Rental Housing, which includes congregate housing, group homes, and Rural Cooperative Housing. Section 515 loans may be made to finance multi-family units in rural areas as defined in §3560.11.

(2) Sections 514 and 516 Farm Labor Housing loans and grants. Housing under these programs may be built in any area with a need and demand for housing for farm workers.

(3) Section 521 Rental Assistance. A project-based tenant rent subsidy which may be provided to Rural Rental Housing and Farm Labor Housing facilities.

(b) The programs covered by this part provide economically designed and constructed rural rental, cooperative, and farm labor housing and related facilities operated and managed in an affordable, decent, safe, and sanitary manner.

(c) Internal Agency procedures containing details for Agency processing under these regulations can be found in the program handbooks, available in any Rural Development office, or from the Rural Development Web site.

§3560.2 Civil rights.

(a) As per the Fair Housing Act, as amended and section 504 of the Rehabilitation Act of 1973, all actions taken by recipients of loans and grants will be conducted without regard to race, color, religion, sex, familial status, national origin, age, or disability. These actions include any actions in the sale, rental, or advertising of the dwellings, in the provision of brokerage services, or in residential real estate transactions involving Rural Housing Service (RHS) assistance. It is unlawful for a borrower or grantee or an agent of a borrower or grantee:

(1) To refuse to make reasonable accommodations in rules, policies, practices, or services that would provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas; or

(2) To refuse to provide a reasonable accommodation at the borrower's expense that would not cause an undue financial or administrative burden, or to refuse to allow an individual with a disability to make reasonable modifications to the unit at their own expense with the understanding that the owner may require the tenant to return the unit to its original condition when the unit is vacated by the tenant making the modifications (see §3560.104(c)).

(b) Borrowers and grantees must take reasonable steps to ensure that Limited English Proficiency (LEP) persons receive the language assistance necessary to afford them meaningful access to USDA programs and activities, free of charge. Failure to ensure that LEP persons can effectively participate in or benefit from federally-assisted programs and activities may violate the prohibition under Title VI of the Civil Rights Act of 1964, 42 U.S.C. 2000d and Title VI regulations against national origin discrimination. USDA has issued guidance to clarify the responsibilities of recipients and subrecipients who receive financial assistance from USDA and to assist them in fulfilling their responsibilities to LEP persons under Title VI of the Civil Rights Act, as amended, and implementing regulations.

(c) Any tenant/member or prospective tenant seeking occupancy in or use of facilities financed by the Agency who believes he or she is being discriminated against because of race, color, religion, sex, familial status, national origin, or disability may file a complaint in person with, or by mail to the U. S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, Washington, DC 20410. Complaints received by Agency employees must be directed to the National Office Civil Rights staff through the State Civil Rights Manager/Coordinator.

(d) Borrowers or grantees that fail to comply with the requirements of federal civil rights requirements are subject to sanctions authorized by law. The following are the major civil rights laws affecting multifamily housing loan and grant programs:

(1) Equal Credit Opportunity Act (ECOA).
(2) Title VI of the Civil Rights Act of 1964.
(3) Title VIII of the Civil Rights Act of 1968.
(4) Section 504 of the Rehabilitation Act of 1973.
(5) Age Discrimination Act of 1975.
(6) Title IX of the Education Amendments of 1972.

§3560.3 Environmental requirements.

RHS will consider environmental impacts of proposed housing as equal with economic, social, and other factors. By working with applicants, Federal agencies, Indian tribes, state and local governments, interested citizens, and organizations, RHS will formulate actions that advance program goals in a manner that protects, enhances, and restores environmental quality. Actions taken under this part must comply with the environmental review requirements in accordance with 7 CFR part 1970. Servicing actions as defined in § 1970.6 of this title are part of financial assistance already provided and do not require additional NEPA review. However, certain post-financial assistance actions that have the potential to have an effect on the environment, such as lien subordinations, sale or lease of Agency-owned real property, or approval of a substantial change in the scope of a project, as defined in § 1970.8 of this title, are actions for the purposes of this part. (Revised 04-01-16, SPECIAL PN.)

§3560.4 Compliance with other Federal requirements.

RHS is responsible for ensuring that the application is in compliance with all applicable Federal requirements, including the following specific requirements:

(a) Intergovernmental review. 7 CFR part 3015, subpart V, or any successor regulation, including the Agency supplemental administrative instruction, RD Instruction 1970-I, available in any Rural Development office.

(b) National flood insurance. The National Flood Insurance Act of 1968, as amended by the Flood Disaster Protection Act of 1973; the National Flood Insurance Reform Act of 1994; and 7 CFR part 1806, subpart B, or any successor regulation.

(c) Clean Air Act and Water Pollution Control Act Requirements. For any contract, all applicable standards, orders or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Water Act, Executive Order 11738, and 40 CFR part 32.

(d) Historic preservation requirements. The provisions of 7 CFR part 1901, subpart F or any successor regulation.

(e) Lead-based paint requirements. The applicable provisions of 24 CFR part 35, subparts A through D, J, and R, as published by the U.S. Department of Housing and Urban Development.

§3560.5 State, local or tribal laws.

Borrowers must comply with all applicable state and local laws, and laws of Federally-recognized Indian tribes to the extent they are not inconsistent with this part.

§3560.6 Borrower responsibility and requirements.

(a) Borrower responsibilities and requirements specified in this part may be carried out by an individual or entity designated by the borrower to act on behalf of the borrower such as a resident manager or management agent. Ultimate accountability to the Agency, however, is with the borrower whether or not the borrower designated another person or entity to act on the borrower's behalf.

(b) Borrowers who have not executed a loan agreement, and who were not required to execute a loan agreement by the regulations in effect at the time of their loan closing are exempt from the requirements of subparts D through G of this part, as long as the borrower is not in default of any applicable requirement, security instrument, payment, or any other agreement with the Agency. Such borrowers must provide evidence of tenant income eligibility in accordance with §3560.152(a), except in Farm Labor Housing where the tenant is not paying shelter cost.

§3560.7 Delegation of responsibility.

The RHS Administrator may delegate, on an individual or other basis, any decision-making responsibility for Agency programs, unless otherwise noted.

§3560.8 Administrator's exception authority.

The RHS Administrator may make an exception to any provision of this part or address any omissions provided that the exception is consistent with the applicable statute, does not adversely affect the interest of the Federal Government, and does not adversely affect the accomplishment of the purposes of the MFH programs or application of the requirement would result in undue hardship on the tenants. Exception requests presented to the RHS Administrator must have the concurrence of a Rural Development State Director or a Deputy Administrator for MFH.

§3560.9 Reviews and appeals.

Rural Housing Service decisions may be appealed pursuant to 7 CFR part 11.

§3560.10 Conflict of interest.

To reduce the potential for employee conflict of interest, all RHS activities will be conducted in accordance with 7 CFR part 1900, subpart D.

§3560.11 Definitions.

Unless otherwise noted, terms listed in this part shall be defined as follows:
Administrator. The head of the Rural Housing Service who reports directly to the Under Secretary for Rural Development in the U.S. Department of Agriculture.

Agency. The Rural Housing Service within the Rural Development mission area of the U.S. Department of Agriculture.

Amortization. Payment of debt in regular, periodic installments of principal and interest, as opposed to interest only payments.

Applicant. An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe, association, or other entity that will be the owner of the project for which an application for funding from the Agency is submitted.

Appraisal. As used by the Agency, a written report developed by a qualified appraiser as established in subpart P that concludes an opinion of value(s) for a specific real property.

Assistance. Financial assistance in the form of a loan, grant, interest credit, or rental assistance.

Association of farmers. Two or more farmers acting as a single legal entity. Association members may include the individual members of farming partnerships or corporations.

Borrower. An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe,
association, or other entity that has received a loan from the Agency.

Capital Needs Assessment. A Capital Needs Assessment is designed to capture and report on the immediate and the long-range capital needs of an individual property. It includes attention to site features, mechanical and electrical systems, building exterior and common area systems, and dwelling unit interiors.

Caretaker. An individual employed by a borrower or a management agent to handle routine interior and exterior maintenance and upkeep of a MFHMFH project.

Congregate housing. A housing program authorized by section 515 of the Housing Act of 1949 which provides housing for elderly persons, individuals with disabilities, and families who require some supervision and central services but are otherwise able to care for themselves. Such housing does not include any licensed healthcare facility.

Consumer cooperative. A corporation organized under the cooperative laws of a state or Federally recognized Indian tribe that will own and operate the housing on a cooperative basis solely for the benefit of its members.

Conventional rents for comparable units (CRCU). Market rents for comparable rental units in conventional housing located in the same geographic area as a particular Section 514, 515, or 516 project.

Current appraisal. An appraisal with a report date that is no more than 1 year old.

Daily Interest Accrual System (DIAS). A system where interest is charged daily on outstanding principal. Level loan payments are made by the borrower. The amount of interest due on any date is equal to the unpaid daily interest that has accrued.

Default. Failure by a borrower to meet significant monetary or non-monetary obligations or terms of a loan, grant, or other agreement with the Agency which remain unpaid or unperformed for more than 30 days after the date such obligation is due or required to be paid or performed, or within time periods specified in notices of compliance violations.

Disability. The term disability is considered equivalent to the term handicap. Eligibility requirements for fully accessible units are contained in §§3560.154(g)(1)(i) and 3560.155(b). A person is considered to have a disability if either of the following two situations occur:

(1) As defined in section 501(b) of the Housing Act of 1949. The person is the head of household (or his or her spouse) and is determined to have an impairment which:

(i) Is expected to be of long-continued and indefinite duration;

(ii) Substantially impedes his or her ability to live independently; and

(iii) Is of such a nature that such ability could be improved by more suitable housing conditions, or if such person has a developmental disability as defined in section 102(7) of the Developmental Disability and Bill of Rights Act (42 U.S.C. 6001(7)).

(2) As defined in the Fair Housing Act; the Americans with Disabilities Act; and section 504 of the Rehabilitation Act of 1973. The person has a physical or mental impairment which substantially limits one or more of such person's major life activities; a record of such impairment; or being regarded as having such an impairment. The term does not include current, illegal use of or addiction to a controlled substance. As used in this definition, physical or mental impairment includes:

(i) Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genito-urinary; hemic and lymphatic; skin; and endocrine;

(ii) Any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term “physical or mental impairment” includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech and hearing impairments, cerebral palsy, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, Human Immunodeficiency Virus infection, mental retardation, emotional illness, drug addiction (other than addiction caused by current, illegal use of a controlled substance), and alcoholism;

(iii) Major life activities means functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working;

(iv) Has a record of such an impairment means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities;

(v) Is regarded as having an impairment means:

(A) Has a physical or mental impairment that does not substantially limit one or more major life activities but that is treated by the borrower or management agent as constituting such a limitation;

(B) Has a physical or mental impairment that substantially limits one or more major life activities only as a result of the attitudes of others toward such impairment; or

(C) Has none of the impairments described in this definition but is treated by another person as having such an impairment.

Disabled domestic farm laborer. An individual with a disability as separately defined in this paragraph and who was a domestic farm laborer at the time of becoming disabled.

Domestic farm laborer. A person who, consistent with the requirements in §3560.576(b)(2), receives a substantial portion of his or her income from farm labor employment (not self-employed) in the United States, Puerto Rico, or the Virgin Islands and either is a citizen of the United States or resides in the United States, Puerto Rico or the Virgin Islands after being legally admitted for permanent residence. This definition may include the immediate family members residing with such a person.

Due diligence on hazardous substances. Due diligence is the process of inquiring into the environmental conditions of real estate, in the context of a real estate transaction to determine the presence of contamination from hazardous substances, and to determine the impact such contamination may have on the market value of the property.

Elderly household or individual with a handicapped household. A household in which the tenant or co-tenant of the household is 62 years old or older or is an individual with a disability. An elderly household may include persons younger than 62 years old and the household of an individual with a handicap may include persons without disabilities.

Elderly person. A person who is at least 62 years old. The term also means a person with a disability as separately defined in this paragraph, regardless of age.

Engagement. An Agency defined financial review of a housing project's financial status that a borrower will contract with a certified public accountant or other qualified individual to perform. An engagement will result in annual financial reports for use by the Agency as described in §3560.308.

Familial status. One or more individuals (who have not attained the age of 18 years) being domiciled with a parent or another person having legal custody of such individual or individuals; or the designee of such parent or other person having such custody, with the written permission of such parent or other person. The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

Family farm corporation or partnership. A private corporation or partnership involved in agricultural production in which at least 90 percent of the stock or interest is owned and controlled by persons related by blood, which shall include parents, siblings, and children, or law. If more than three separate households are supported by the farming operation, the family farm corporation or partnership must be:

(1) Legally organized and authorized to own and operate a farm business within the state;

(2) Legally able to carry out the purposes of the loan; and

(3) Prohibited from the sale or transfer of 90 percent of the stock or interest to other than family members by either the articles of incorporation, bylaws or by agreement between the stockholders or partners and the corporation or partnership.

Farm. A tract or tracts of land, improvements, and other appurtenances that are used or will be used in the production of crops, livestock, or aquaculture products for sale in sufficient quantities so that the property is recognized as a farm rather than a rural residence. The term "farm" also includes the term "ranch." It may also include land and improvements and facilities used in a non-eligible enterprise or the residence that, although physically separate from the farm acreage, is ordinarily treated as part of the farm in the local community.

Farmer. A person who is actually involved in day to day on-site operations of a farm and who devotes a substantial amount of time to personal participation in the conduct of the operation of a "farm."

Farm labor. Services in connection with cultivating the soil, raising or harvesting any agriculture or aquaculture commodity; or in catching, netting, handling, planting, drying, packing, grading, storing, or preserving in the unprocessed stage, without respect to the source of employment (but not self-employed), any agriculture or aquaculture commodity; or delivering to storage, market, or a carrier for transportation to market or to processing any agricultural or aquacultural commodity in its unprocessed stage.

Farm labor contractor. A person--other than an agricultural employer, a member of an agricultural association, or an employee of an agricultural employer or agricultural association--who recruits, solicits, hires, employs, furnishes, or transports any year-round or seasonal migrant farm laborer for money or other valuable consideration.

Farm labor housing. On-farm or off-farm housing for farm laborers authorized by section 514 and section 516 of the Housing Act of 1949.

Farm owner. A natural person, persons, or legal entity who are the owners of a "farm" as this term is further defined in this section.

Foreclosure. A proceeding in or out of court to extinguish all rights, title, and interest of the owners of property in order to sell the property to satisfy a lien against it.

General overhead. Includes general operation items necessary for the contractor to be in business. They may include, but are not limited to the following: tools and minor equipment; worker's compensation and employer's liability; unemployment tax; Social Security and Medicare; manager's, clerical, and estimator's salaries; pension and bonus plans; main office insurance, rental, utilities, miscellaneous expenses; general liability insurance; legal, accounting, and data processing; automotive and light truck expense; vehicle expenses; depreciation of overhead capital expenditures; and office equipment maintenance.

General requirements. Includes items that are required in the construction contract for the contractor to provide for the specific project. They do not include items that pertain to a specific trade nor overhead expenses of the contractor's general operation. Items may include, but are not limited to, the following: Field supervision; field engineering such as field office, sheds, toilets, phone; performance and payment or latent defects bonds; cost certification; building permits; site security; temporary utilities; property insurance; and cleaning or rubbish removal.

Grantee. An entity that has received a grant from the Agency.

Group home. Housing that is occupied by elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

Household. The tenant or co-tenant and the persons or dependents living with a tenant or co-tenant, but not including a resident assistant.

Household furnishings. Basic durable items such as stoves, refrigerators, drapes, drapery rods, tables, chairs, dressers and beds.

Housing project. A property with two or more affordable, decent, safe and sanitary rental units and related facilities operated under one management plan and financed with funds appropriated under the authority of sections 515, 514, or 516 of the Housing Act of 1949.

Identity-of-Interest (IOI). A relationship between applicants, borrowers, grantees, management agents, or suppliers of materials or services described under, but not limited to, any of the following conditions:

(1) There is a financial interest between the applicant, borrower, grantee and a management agent or the supplying entity;

(2) One or more of the officers, directors, stockholders or partners of the applicant, borrower, or management agent is also an officer, director, stockholder, or partner of the supplying entity;

(3) An officer, director, stockholder, or partner of the applicant, borrower, or management agent has a 10 percent or more financial interest in the supplying entity;

(4) The supplying entity has or will advance funds to an applicant, borrower, or management agent;

(5) The supplying entity provides or pays on behalf of the applicant, borrower, or management agent the cost of any materials or services in connection with obligations under the management plan or management agreement;

(6) The supplying entity takes stock or a financial interest in the applicant, borrower, or management agent as part of the consideration to be paid them; or

(7) There exists or come into being any side deals, agreements, contracts or understandings entered into thereby altering, amending, or canceling any of the management plan, management agreement documents, organization documents, or other legal documents pertaining to the property, except as approved by the Agency.

Indian tribe. The term "Indian tribe" means any Indian tribe, band, group, and nation, including Alaskan Indians, Aleuts, and Eskimos, and any Alaskan-Native Village, which is considered an eligible recipient under the Indian Self-Determination and Education Assistance Act (Public Law 93-638) or under the State and Local Fiscal Assistance Act of 1972 (Public Law 92-512).

Interest credit. A form of assistance available to eligible borrowers that reduces the effective interest rate of the loan.

Lease. A contract setting forth the rights and obligations of a tenant or cooperative member and a property owner, including charges and terms under which a tenant or cooperative member will occupy or use the housing or related facilities.

Legal or qualified alien. Legal or qualified alien refers to any person lawfully admitted to the country who meets the criteria in section 214 of the Housing and Community Development Act of 1980, 42 U.S.C. 1436a.

Letter of Priority Entitlement (LOPE). A letter issued by the Agency providing a tenant with priority entitlement to rental units in other Agency-financed housing projects for 120 days from the date of the LOPE.

Life cycle cost. The life cycle cost has 2 purposes: (1) To determine the expected usable life (utility) of a building component or furnishing and (2) to determine which building components or furnishings are the most cost efficient over the life of the building. Cost efficient is not to be construed to mean the least initial cost.

Life cycle cost analysis. Life cycle cost analysis is the comparison of different materials to examine anticipated useful life and the cost of using a specific material or building component. The analysis has multiple uses, such as: (1) To conduct a cost efficiency comparison between products, (2) for developing component replacement time tables, and (3) for estimating future component replacement costs. Life cycle cost analysis can be accomplished through various methods, such as; insurance actuary tables or Agency documentation of a component's life expectancy. Life cycle cost analysis is conducted by a design professional. For Agency financed projects, a life cycle cost analysis is to be conducted for specific components: (1) drives and parking, (2) roofing system and roofing material, (3) exterior finishes, and (4) energy source items.

Limited Liability Company (LLC). An unincorporated organization of one or more persons or entities established in accordance with applicable state laws and whose members may actively participate in the organization without being personally liable for the debts, obligations or liabilities of the organization.

Limited partnership. An ownership arrangement consisting of general and limited partners; general partners manage the business, while limited partners are passive and liable only for their own capital contributions.

Loan agreement. A written agreement between the Agency and the borrower that sets forth the borrower's responsibilities with respect to Agency financing.

Low-income household. A household that has an adjusted income that is greater than the Department of Housing and Urban Development's (HUD) established very-low income limit, but that does not exceed the HUD established low-income limit (generally 80 percent of median income adjusted for household size for the county where the property is or will be located).

Low-Income Housing Tax Credit (LIHTC). A federal tax credit allowed for investment in qualified low-income housing administered by the Internal Revenue Service (IRS) under section 42 of the Internal Revenue Code.

Management agent. A firm or individual employed or designated by a borrower to act on the borrower's behalf in accordance with a written management agreement.

Management agreement. A written agreement between a borrower and a management agent setting forth the management agent's responsibilities and fees for management services.

Management fee. The compensation provided to a management agent for services provided in accordance with a management agreement.

Management plan. A detailed description of the policies and procedures to be followed by the borrower in managing a MFH project.

Manufactured housing. Housing, constructed of one or more factory-built sections, which includes the plumbing, heating, and electrical systems contained therein, which is built to comply with the Federal Manufactured Home Construction and Safety Standards (FMHCSS), and which is designed to be used with a permanent foundation.

Market area. The geographic or locational delineation of the market for a specific project, including outlaying areas that will be impacted by the project, i.e., the area in which alternative, similar properties effectively compete with the subject property.

Market rent. The most probable rent that a property should bring in a competitive and open market reflecting all conditions and restrictions of the specified lease agreement, including term, rental adjustment and revaluation, permitted uses, use restrictions, and expense obligations; the lessee and lessor each acting prudently and knowledgeably, and assuming consummation of a lease contract as a specified date and the passing of the leasehold from lessor to lessee.

Maximum debt limit. The maximum amount that the Agency will lend or grant for a MFHMFH project based on the appraised value or total development cost excluding costs ineligible for payment from loan or grant funds, whichever is less, reduced by all funding available to the borrower from sources other than the Agency, multiplied by 95, 97, or 102 percent depending upon the applicant entity and their use of the low-income housing tax credit, in accordance with §3560.63(b).

Member or co-member. A stockholder or other person who has executed documents or stock pertaining to a cooperative housing type of living arrangement and has made a commitment to upholding the cooperative concept.

Migrants or migrant agricultural laborer. A person (and the family of such person) who receives a substantial portion of his or her income from farm labor employment and who establishes a residence in a location on a seasonal or temporary basis, in an attempt to receive farm labor employment at one or more locations away from their home base state, excluding day-haul agricultural workers whose travels are limited to work areas within one day of their residence.

Minor. An individual under 18 years of age who is a dependent of a tenant or an individual age 18 or older who is a full-time student and a dependent of a tenant.

Moderate-income household. A household that has an adjusted income that is greater than the HUD-established low-income limit, but does not exceed the low-income limit by more than $5,500.

Mortgage or Deed of Trust. A form or security instrument or consensual lien on real property.

Net recovery value. The value realized from the Government's acquisition of security property in a default situation after subtracting all costs, actual or anticipated, from acquiring, holding, and disposing of the security property.

New construction. A MFHMFH project being constructed to be occupied for the first time.

Nonprofit organization. A private organization that:

(1) Is organized under state or local laws;

(2) Has no part of its net earnings inuring to the benefit of any member, founder, contributor, or individual; and

(3) Is approved by the Secretary of Agriculture and considered to be financially responsible.

Nonprofit organization for section 515 program (Prepayment or Purchase). To be eligible to purchase properties under the conditions of subpart N of this part, nonprofit organizations may not have among their officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under section 515 that have been prepaid or have requested prepayment.

Nonprofit organization of farm workers. A nonprofit organization, as defined in this section, whose membership is composed of at least 51 percent farm workers.

Notice of Funding Availability (NOFA). A “Notice of Funding Availability” issued by the Agency to inform interested parties of the availability of assistance and other matters pertinent to the program.

Occupancy agreement. A contract establishing the rights and obligations of the cooperative member and the cooperative, including the amount of the monthly occupancy charge and the other terms under which the member will occupy the housing.

Occupancy charge. The amount of money charged a cooperative member to cover their proportional share of the cooperative's operating costs and cash requirements.

Off-farm labor housing. Housing for farm laborers in any location approved by the Agency but not on the farm where the laborer works.

Office of the General Counsel (OGC). The USDA Office of the General Counsel, including the Regional Attorney, Associate Regional Attorney, or Assistant Regional Attorney.

Office of the Inspector General (OIG). The USDA Office of the Inspector General.

On-farm labor housing. Housing for farm laborers located on the farm where they work that is away from service buildings or in the nearby community.

Overage. That portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal to the difference between the note rent for a unit and the basic rent.

Plan I. A type of interest subsidy available to borrowers prior to October 27, 1980. Budgets and rental rates developed for Plan I loans are based on a 3 percent loan amortization.

Plan II. A type of interest subsidy available to borrowers operating on a limited profit basis. Budgets and rental rates developed for Plan II loans are based on both the loan being amortized at the interest rate shown on the promissory note and at a 1 percent subsidized rate.

Predetermined Amortization Schedule System (PASS). A system where loan payments are applied based on an amortization schedule.

Prepayment. Payment in full of the outstanding balance on an Agency loan prior to the note's originally scheduled maturity date.

Program requirements. All provisions related to MFHMFH contained in the loan document, grant agreement, statute, regulation, handbook, or administrative notice.

Promissory note. A legal document containing conditions (interest rate and timing) for repayment of indebtedness.

Real estate owned (REO) property. The real estate owned by the Agency acquired through voluntary conveyance, foreclosure or other action.

Rehabilitation. Rehabilitation is when the remodeling of a property is of a complex nature involving structural repairs or when two or more of the life cycle cost components are included in the remodeling of a property.

Related facilities. Facilities in a MFHMFH project that are related to the housing and are in addition to rental units, (e.g., community rooms or buildings, cafeterias, dining halls, infirmaries, child care facilities, assembly halls, and essential service facilities such as central heating, sewerage, lighting systems, clothes washing facilities, trash disposal and safe domestic water supply).

Rent. The amount established as a charge for occupancy in a rental unit of Agency-financed MFH. Rents must be established at the same rate for all similar units in the housing project. The following terms are used to describe rents for various program purposes.

(1) Note rent is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in the promissory note.

(2) Basic rent is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in the promissory note reduced by the interest credit agreement.

(3) HUD contract rent is the rental charge established for housing receiving project-based Section 8 rental subsidies in accordance with 24 CFR part 880 or part 884, as applicable.

(4) Low-income housing tax credit (LIHTC) rent is the rental charge established in accordance with LIHTC requirements.

Rental assistance (RA). The portion of the approved shelter cost paid by the Agency to compensate a borrower for the difference between the approved shelter cost and the tenant contribution when such contribution is less than the basic rent.

Rental assistance units. Dwelling units in a MFH project qualified for rental assistance. There are three types of rental assistance units.

(1) New construction units are units provided in conjunction with initial loans for construction or substantial rehabilitation of the MFHMFH projects.

(2) Replacement units are Agency-funded rental assistance units which replace units with expiring rental assistance agreements or which replace Section 8 units which have expired under the Section 8 contract.

(3) Servicing units are units provided to an operational MFHMFH project as a part of the Agency's general loan servicing or preservation activities.

Repair and replacement. Repair and replacement is the restoration of minor building materials, elements, components, equipment and fixtures. Examples include: Painting, carpeting, appliances, cabinets, and other fixtures.

Resident assistant. A person residing in a rental unit who is essential to the well-being and care of an elderly person or an individual with a disability, but who:

(1) Is not obligated for the tenant's financial support;

(2) Would not be living in the unit except to provide the needed services;

(3) May be a family member, but is not a dependent of the tenant for tax purposes;

(4) Is not subject to the eligibility requirements of a tenant; and

(5) Is not considered a household member in the determination of household income.

Resident or site manager. The individual employed by the borrower and who is responsible for the day-to-day operations of the housing.

Retired domestic farm laborer. An individual who is at least 55 years of age and who has spent the last 5 years prior to retirement as a domestic farm laborer or spent the majority of the last 10 years prior to retirement as a domestic farm laborer.

Return on Investment (ROI). The annual amount of profit an owner operating on a limited or full profit basis may withdraw from a project, as established in the loan agreement. The amount is calculated as a percentage of the owner's investment in the project.

Rural area. Any open country, or any place, town, village, or city which is not (except in the cases of Pajaro, in the State of California, and Guadalupe, in the State of Arizona) part of or associated with an urban area and which (1) has a population not in excess of 2,500 inhabitants, or (2) has a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or (3) has a population in excess of 10,000 but not in excess of 20,000 and (A) is not contained within a standard metropolitan statistical area, and (B) has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary and the Secretary of

Housing and Urban Development. For purposes of this title, any area classified as 'rural' or a 'rural area' prior to October 1, 1990, and determined not to be 'rural' or a 'rural area' as a result of data received from or after the 1990 or 2000 decennial census shall continue to be so classified until the receipt of data from the decennial census in the year 2010, if such area has a population in excess of 10,000 but not in excess of 25,000, is rural in character, and has a serious lack of mortgage credit for lower and moderate-income families. Notwithstanding any other provision of this section, the city of Plainview, Texas, shall be considered a rural area for purposes of this title, and the city of Altus, Oklahoma, shall be considered a rural area for purposes of this title until the receipt of data from the decennial census in the year 2000.

Rural Cooperative Housing (RCH). A housing program authorized under section 515 of the Housing Act of 1949, in which a consumer cooperative, organized and operating on a nonprofit basis, may own and operate a MFHMFH development.

Rural Housing Service (RHS). The Agency within the Rural Development mission area of the U.S. Department of Agriculture or its successor agency which administers programs authorized by sections 514, 515, 516, and 521 of the Housing Act of 1949, as amended.

Rural Rental Housing (RRH). A housing program authorized by section 515 of the Housing Act of 1949 to provide rental housing in rural areas for persons of very-low, low- and moderate income.

Seasonal housing. Housing operated on a seasonal basis, typically for migrants or migrant agricultural laborers as opposed to year round.

Security deposit. A one-time fee charged a tenant prior to occupancy of a unit to cover possible loss or damage to the housing unit caused by the tenant.

Self-employed. A person who meets the IRS definition of self-employed at 26 CFR 1.401-10.

Service agreement. A written agreement between a borrower and a service provider establishing the specific service to be provided to a MFH project, the cost of the service, and the length of time the service will be provided.

Service plan. A written plan describing how services will be provided to a MFH project and which, at a minimum, must specify the services to be provided, the frequency of the services, who will provide the services, how tenants will be advised of the availability of services, and the staff needed to provide the services.

Service provider. A person who signs a written agreement with a borrower to provide services to a MFH project.

Shelter costs. Basic or note rent plus the utility allowance, when used, or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

Sources and Uses Comprehensive Evaluation (SAUCE). A computer software program used by the Agency to analyze the total funds provided to a MFH project to ensure that the Agency is not providing excess assistance.

Special note rent (SNR). A rental rate charged at a Plan II project experiencing vacancies that is less than note rent but higher than basic rent.

State consolidated plan. A planning document for an individual state that includes a housing and homeless needs assessment; a housing market analysis; a strategic plan for addressing the state's housing challenges; an Action Plan that is an annual description of the state's Federal and other resources that are expected to be available to address its priority housing needs and how the Federal funds will leverage other resources; certifications relating to fair housing, its antidisplacement and relocation plan, a drug-free workplace, and other statutory and program requirements; and a monitoring plan to ensure that the state is using its Federal funds appropriately and effectively.

Tenant or co-tenant. An individual who signs a lease and occupies or will occupy a rental unit in a MFH project. The term tenant or co-tenant also refers to a member of cooperative housing occupying or planning to occupy a dwelling unit in cooperative housing.

Tenant contribution. The portion of the approved shelter cost paid by the tenant household. The proportion of tenant income and adjusted income paid will vary according to the type of subsidy provided to the tenant household.

Total development cost (TDC). The cost of constructing, purchasing, improving, altering, or repairing MFH and related facilities, buying household furnishings (for sections 514/516 only), and purchasing or improving the necessary land, including architectural, engineering, or legal fees, and charges and other technical and professional fees and charges, but excluding fees, charges, or commissions such as payments to brokers, negotiators, or other persons for the referral of prospective applicants or solicitations of loans. Although a developer's fee is part of the project's development cost, such fees are not eligible for payment from Agency loan or grant funds and are not included in determining the Agency authorized development cost.

Utility allowance. An amount determined by a borrower as the amount to be considered a tenant's portion of utility cost in the calculation of a tenant's total shelter cost when utility costs are not included in the rent.

Very low-income household. A household that has an adjusted income that does not exceed the HUD established very low-income limit (generally 50 percent of median income adjusted for household size in the county where the property is or will be located).Workout agreement. An agreement between a borrower and the Agency listing actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

§§3560.12-3560.49 [Reserved]

§3560.50 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart B--Direct Loan and Grant Origination

§3560.51 General.

This subpart contains the Agency's loan origination requirements for multi-family housing (MFH) direct loans for Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing. Additional requirements for farm labor housing loans and grants are contained in subpart L of this part for Off-Farm Labor Housing and subpart M of this part for On-Farm Labor Housing.

§3560.52 Program objectives.

The Agency uses appropriated funds to finance the construction, rehabilitation of program properties, or purchase and rehabilitation of MFH and related facilities to serve eligible persons in rural areas. The Agency encourages the use of such financing in conjunction with funding or financing from other sources.

§3560.53 Eligible use of funds.

Funds may be used for the following purposes.

(a) Construct housing. Funds may be used to construct MFH.

(b) Purchase and rehabilitate buildings. Funds may be used to purchase and rehabilitate buildings that have not been previously financed by the Agency.

(1) Rehabilitation must meet the definition of either moderate or substantial rehabilitation as defined in 7 CFR part 1924, subpart A.

(2) The building to be rehabilitated must be structurally sound and the improvements to the building must be necessary to meet the requirements of decent, safe, and sanitary living units.

(3) The total development cost (TDC) for the purchase and rehabilitation of existing buildings must not be more than the estimated TDC for construction of a similar type and unit size property in the same area.

(c) Subsequent loans. Funds may be used to provide subsequent loans in accordance with the provisions of §3560.73.

(d) Purchase and improve sites. Funds may be used to purchase and improve the site on which MFH will be located, provided that the amount of loan funds used to purchase the site does not exceed the appraised market value of the site immediately prior to purchase.

(e) Develop and install necessary systems. Funds may be used to install streets, a water supply, sewage disposal, heating and cooling systems, electric, gas, solar, or other power sources for lighting and other features necessary for the housing. If such facilities are located off-site, loan funds may only be used if the following additional requirements are met:

(1) The loan applicant will hold title to the facility or have a legal right to use the facility in the form of an easement or other instrument acceptable to the Agency for a period of at least 50 percent longer than the term of the loan or grant and the title or right is transferable to any subsequent owner of the housing.

(2) The facilities will either be provided for the exclusive use of the proposed housing project, or Agency funds are limited to the prorated part of the total cost of the facility according to the use and benefit to the MFH project. If entities other than the housing project financed by the Agency use the facilities on a reimbursable fee basis, the loan applicant must agree, in writing, to apply any fees collected in excess of operating expenses to their Agency loan account as an extra loan payment.

(f) Landscaping and site development. Funds may be used to provide landscaping and site development related to a MFH project such as lighting, walks, fences, parking areas, and driveways.

(g) Tenant-related facilities. Funds may be used to develop tenant-related facilities appropriate to the size, economics, and prospective tenants of a MFH project, such as a community room, development of space for education and training purposes for tenants, central laundry facility, outdoor seating, space for passive recreation, tot lots, and a small emergency care infirmary. In congregate housing and group homes, funds may be used for central cooking and dining areas.

(h) Management-related facilities. Funds may be used to develop management-related facilities appropriate to the size and economics of a MFH project such as a maintenance workshop, storage facilities, office, and living quarters for a resident manager and other personnel.

(i) Purchase and install equipment and appliances. Funds may be used to purchase and install equipment and appliances affixed to the property as customary and appropriate for the area in which the housing is located.

(j) Household furnishings (Section 514/516). For farm labor housing sections 514 and 516 only, funds may be used to purchase household furnishings.

(k) Initial operating capital. Loan funds equal to 2 percent of total development cost or appraised value, whichever is less, may be used by a state or political subdivision thereof, Indian tribe, consumer cooperative, or any public or private nonprofit borrower who is not receiving low-income housing tax credits (LIHTC), to make the initial operating capital contribution required by §3560.64. Other borrowers must use their own resources to make the required initial operating capital contribution and may not use loan funds for that purpose.

(l) Builder's profit, overhead and general requirements. Subject to the following limits, funds may be used for builder's profit, overhead and general requirements.

(1) Up to 10 percent of the construction contract may be used for builder's profit.

(2) Up to 4 percent of the construction contract may be used for general overhead.

(3) Up to 7 percent of the construction contract may be used for general requirements.

(m) Legal, technical and professional services. Funds may be used for the costs of legal, technical, and professional services related to the borrower's MFH project, including appraisals, environmental documentation, and construction plans and specifications.

(n) Permit and application fees. Funds may be used for required MFH permits and application fees.

(o) Reimbursement to nonprofit organizations and public bodies. Funds may be used to reimburse a nonprofit organization or public body for up to 2 percent of total development costs for section 515, or up to 4 percent of total development costs for off-farm labor housing, for costs that are reasonable and typical for the area, including:

(1) Development and packaging of a loan application and a MFH proposal; and

(2) Legal, technical, and professional fees incurred in the formation of the loan application and MFH proposal; or

(3) Technical assistance from another nonprofit organization to assist in the organization's formation and in the development and packaging of a loan application and MFH proposal.

(p) Educational programs. Funds may be used for educational programs related to owning and managing a cooperative housing project for the board of directors of a housing cooperative during the first year of the housing operation. Such funds will be available from the initial operating account. The amount of the funds disbursed will be subject to Agency approval and availability of financial resources from the project.

(q) Interest and customary charges. Funds may be used for interest accrued and customary charges necessary to obtain interim financing.

(r) Purchase housing from an interim lender. Funds may be used to purchase MFH from an interim lender that holds fee simple title to Agency-financed housing upon which construction commenced and a letter of commitment had been issued by the Agency but the original applicant for whom funds were obligated will not or cannot continue with construction of the housing. In order for the purchase to take place, there must be no outstanding unpaid obligations in connection with the housing.

(s) Uniform Relocation Assistance and Real Property Acquisition Act of 1970. Funds may be used for necessary costs incurred to comply with the Uniform Relocation Assistance and Real Property Acquisition Act of 1970.

(t) Demonstration programs. With the RHS Administrator's approval, funds may be used to construct demonstration housing involving innovative units and systems which do not meet existing published standards, rules, regulations, or policies but meet the intent of providing affordable, decent, safe, and sanitary rural housing, and are consistent with the requirements of Title V of the Housing Act of 1949.

(u) Conversion of section 502 properties. In accordance with §3560.506, loan funds may be used to finance the conversion of real estate owned units originally financed under Section 502 of the Housing Act of 1949, to MFH authorized by section 515 of the Housing Act of 1949.

§3560.54 Restrictions on the use of funds.

(a) Ineligible uses of funds. Funds may not be used for:

(1) Housing intended to serve temporary and transient residents, with the exception of housing to serve migrant farm workers in accordance with §3560.554;

(2) Special care facilities or institutional-type homes;

(3) Facilities which are not in compliance with the design requirements specified in §3560.60;

(4) Any costs associated with space in a housing project that is leased for commercial use or any commercial facilities except essential service-type facilities when otherwise not conveniently available;

(5) Specialized equipment for training and therapy;

(6) Operating capital for a central dining facility or any items which do not become affixed to the real estate security with the exception of household furnishings for farm labor housing units financed under sections 514 and 516;

(7) Compensation to a loan applicant for value of land contributed in excess of the equity contribution requirements in §3560.63 (c);

(8) Refinancing of an applicant's debt except when the debt involves interim financing or when refinancing is necessary to obtain a release of an existing lien on land owned by a nonprofit organization;

(9) Payment of any fee, charge, or commission to a broker or anyone else as a developer's fee or for referral of a prospective loan applicant or solicitation of a loan;

(10) Payment to any officer, director, trustee, stockholder, member, or agent of an applicant; or

(11) Purchasing land for a site in excess of what is needed, except when:

(i) The applicant cannot acquire an alternate site or cannot acquire the needed land as a separate parcel;

(ii) The applicant agrees to sell the excess land as soon as practical and to apply the proceeds to the loan; and

(iii) Program site density requirements are met in accordance with the site requirements established under §3560.58.

(b) Obligations incurred before loan approval. Funds may not be used for expenses incurred by an applicant prior to approval except when all the following conditions are met:

(1) The debts were incurred for eligible purposes;

(2) Contracts, materials, construction, and any land purchased meet Agency standards and requirements;

(3) Payment of the debts will remove any attached liens and any basis for liens that may attach to the property on account of such debts; and

(4) The completion of environmental review requirements in accordance with 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)

§3560.55 Applicant eligibility requirements.

Applicants for off-farm labor housing loans and grants should also refer to §3560.555, and applicants for on-farm labor housing loans should refer to §3560.605.

(a) General. To be eligible for Agency assistance, applicants must meet the following requirements:

(1) Be a U.S. citizen or qualified alien(s); a corporation; a state or local public Agency; an Indian tribe as defined in §3560.11; or a limited liability company (LLC), nonprofit organization, consumer cooperative, trust, partnership, or limited partnership in which the principals are U.S. citizens or qualified aliens;

(2) Be unable to obtain similar credit elsewhere at rates that would allow for rents within the payment ability of eligible residents;

(3) Possess the legal and financial capacity to carry out the obligations required for the loan or grant;

(4) Be able to maintain, manage, and operate the housing for its intended purpose and in accordance with all Agency requirements;

(5) With the exception of applicants who are a nonprofit organization, housing cooperative or public body, be able to provide the borrower contribution from their own resources (this contribution must be in the form of cash, or land, or a combination thereof);

(6) Have or be able to obtain a minimum of 2 percent of the total development costs for use as initial operating capital (for nonprofit organizations, cooperatives, or public bodies, this amount may be financed through Agency funds); and

(7) Not be suspended, debarred, or excluded based on the "List of Parties Excluded from Federal Procurement and Nonprocurement Programs." The list is available to Federal agencies from the U.S. Government Printing Office. Non-federal parties should contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, (202) 512-1800.

(8) Not delinquent on Federal debt or a Federal judgment debtor, with the exception of those debtors described in §3560.55 (b).

(b) Additional requirement for applicants with prior debt. If an applicant or the managing general partner of a borrower, as well as any affiliated entity having a 10 percent or more ownership interest, has a prior or existing Agency debt, the following additional requirements must be met.

(1) The applicant must be in compliance with any existing loan or grant agreements and with all legal and regulatory requirements or must have an Agency-approved workout agreement and be in compliance with the provisions of the workout agreement. The Agency may require that applicants with monetary or non-monetary deficiencies be in compliance with an Agency-approved workout agreement for a minimum of 6 consecutive months before becoming eligible for further assistance.

(2) The applicant must be in compliance with the Title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, and all other applicable civil rights laws.

(c) Additional requirements for nonprofit organizations. In addition to the eligibility requirements of paragraphs (a) and (b) of this section, nonprofit organizations must meet the following criteria:

(1) The applicant must have received a tax-exempt ruling from the IRS designating the applicant as a 501(c)(3) or 501(c)(4) organization.

(2) The applicant must have in its charter the provision of affordable housing.

(3) No part of the applicant's earnings may benefit any of its members, founders, or contributors.

(4) The applicant must be legally organized under state and local law.

(5) In the case of off-farm labor housing loans and grants, nonprofit organizations must be "broad-based" nonprofit organizations (refer to §3560.555(a)(1)).

(d) Additional requirements for limited partnerships. In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, limited partnership loan applicants must meet the following criteria:

(1) The general partners must be able to meet the borrower contribution requirements if the partnership is not able to do so at the time of loan request.

(2) The general partners must maintain a minimum 5 percent financial interest in the residuals or refinancing proceeds in accordance with the partnership organizational documents.

(3) The partnership must agree that new general partners can be brought into the organization only with the prior written consent of the Agency.

(e) Additional requirements for Limited Liability Companies (LLCs). In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, LLC loan applicants must meet the following criteria:

(1) One member who holds at least a 5 percent financial interest in the LLC must be designated the authorized agent to act on the LLC's behalf to bind the LLC and carry out the management functions of the LLC.

(2) No new members may be brought into the organization without prior consent of the Agency.

(3) The members must commit to meet the equity contribution requirements if the LLC is not able to do so at the time of loan request.

§3560.56 Processing section 515 housing proposals.

Processing requirements for farm labor housing proposals are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) Notice of Funding Availability (NOFA) responses.

(1) The Agency will publish an annual NOFA with deadlines and other information related to submission of new construction MFH proposals, including expansion of existing MFH in designated places selected in accordance with §3560.57.

(2) To be eligible for funding consideration, MFH proposals must be submitted in accordance with the NOFA and must provide information requested in the NOFA for the Agency to score and rank the proposals.

(3) MFH proposals needing rental subsidies must include requests for Agency rental assistance or a description of any non-Agency rental subsidy to be used with the proposal and must provide information required by §3560.260 (c).

(4) The Agency will consider housing proposals requesting rental assistance in rank order to the extent rental assistance is available. When there is no rental assistance available, the Agency will consider only those housing proposals in rank order that do not require rental assistance.

(b) Preliminary proposal assessment. The Agency will make a preliminary assessment of the application using the following criteria and will reject those applications which do not meet all of these criteria:

(1) The proposal was received by the submission deadline specified in the NOFA,

(2) The proposal is complete as specified in the NOFA,

(3) The proposal is for an authorized purpose, and

(4) The applicant meets Agency eligibility requirements.

(c) Scoring and ranking project proposals. The Agency will score and rank each housing proposal that meets the criteria of paragraph (b) of this section.

(1) The following criteria will be used to score housing proposals as more completely established in the NOFA:

(i) The presence and extent of leveraged assistance in the proposal for the units that will serve tenants meeting Agency income limits at basic rents comparable to what the rent would be if the Agency provided full financing.

(ii) The proposal will provide rental units in a colonia, tribal land, Rural Economic Area Partnership (REAP) community, Enterprise Zone or Empowerment Community (EZ/EC) or in a place identified in the state Consolidated Plan or a state needs assessment as a high need community for MFH.

(iii) The proposal supports Agency initiatives announced in the NOFA.

(iv) The proposal uses a donated site which meets the following conditions:

(A) The site is donated by a state, unit of local government, public body or a nonprofit organization;

(B) The site is suitable for the housing proposals and meets Agency requirements;

(C) Site development costs do not exceed what they would be to purchase and develop an alternative site;

(D) The overall cost of the MFH is reduced by the donation of the site; and

(E) A return on investment is not paid to the borrower for the value of the donated site nor is the value of the site considered as part of the borrower's contribution.

(2) The Agency will rank housing proposals based on their scoring.

(i) When proposals have an equal score, preference will be given to Indian tribes as defined in §3560.11 and local nonprofit organizations or public bodies whose principal purposes include low-income housing that meet the conditions of §3560.55(c) and the following conditions.

(A) Is exempt from Federal income taxes under section 501(c)(3) or 501(c)(4) of the Internal Revenue code;

(B) Is not wholly or partially owned or controlled by a for-profit or limited-profit type entity;

(C) Whose members, or the entity, do not share an identity of interest with a for-profit or limited-profit type entity;

(D) Is not co-venturing with another entity; and

(E) The entity or its members will not be receiving any direct or indirect benefits pursuant to LIHTC.

(ii) A drawing will be held in the event of a tie score, first for proposals from applicants who meet the conditions of paragraph (c)(2)(i) of this section and next for proposals from applicants for which paragraph (c)(2)(i) of this section is not applicable. Each proposal will be numbered in the order in which it is drawn.

(3) The Agency will request initial loan applications from parties who submitted the housing proposals with the highest ranking, taking into consideration available funds. The Agency will notify non-selected parties with the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(d) Processing initial loan applications. The Agency will review all initial loan applications submitted in accordance with Agency requirements to further evaluate the eligibility and feasibility of the housing proposals. This determination will include:

(1) A review of the preliminary plans and cost estimates,

(2) A market feasibility review,

(3) An Agency site visit to gather preliminary environmental information and determine that the proposed site meets the site requirements of §3560.58,

(4) A review of the Affirmative Fair Housing Marketing Plan,

(5) An analysis of current credit reports,

(6) A review of Civil Rights Impact Analysis in accordance with 7 CFR part 2006, subpart P, and

(7) Completion of environmental review requirements in accordance with 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)

(e) Processing order of initial loan applications. The Agency will process initial loan applications in rank order, taking into account available funds. If any initial loan applications are withdrawn, rejected, or delayed for a period of time that will not permit funding in the current funding cycle, the Agency will process, in rank order, the next initial loan application as funding levels permit.

(f) Other assistance. During each stage of loan application processing, loan applicants must notify the Agency of all other assistance, including other Federal Government assistance proposed or approved for use in connection with the loan application.

(g) Proposal withdrawal or rejection. An applicant may withdraw a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process with a written request. The Agency may reject a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process when an applicant fails to provide information requested by the Agency within the time frame specified by the Agency.

(h) Final applications. Applicants, with initial loan applications that are selected by the Agency for further processing, must submit a final application, with any additional information requested by the Agency, to confirm and document a housing proposal's eligibility and feasibility, including an affirmative fair housing marketing plan. The Agency will notify applicants with initial loan applications that are not selected for further processing of their non-selection, the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(i) Rural cooperative housing proposals. Rural cooperative housing loan proposals will be solicited through a NOFA and will be assessed and processed in the same manner described in paragraphs (a) through (h) of this section.

§3560.57 Designated places for section 515 housing.

(a) Establish a list of designated places. The Agency will establish a list of designated places from which loan proposals will be accepted. The list is updated each fiscal year and is available when the NOFA is published. The NOFA provides information on obtaining the list. This list will be developed from a list of rural places which the Agency identifies as having the greatest need for multifamily housing based on the following factors:

(1) Qualification as a rural area as defined in §3560.11,

(2) Lack of mortgage credit, and

(3) Demonstrated need for MFH based on:

(i) The incidence of poverty,

(ii) The existence of substandard housing,

(iii) The lack of affordable housing, and

(iv) The following high need areas:

(A) Places identified in the state Consolidated Plan or similar state plan or needs assessment report,

(B) Indian reservations or communities located within the boundaries of tribal allotted or trust land, and

(C) EZ/EC or REAP communities.

(b) Establishing partnership designated place list. The Agency, in states with an active leveraging program and formal partnership agreement with the state agency, may establish a partnership designated place list consisting of places identified by the partnership as high need areas based on criteria consistent with the Agency's and the state's authorizing statutes. The partnership agreement and partnership designated place list must have the concurrence of the Administrator.

(c) Administrator's discretion. The Administrator may add to the list of designated places any place that is determined to have a compelling need for MFH, for example, a place that has had a substantial increase in population not reflected in the most recent census data, or a place that has experienced a loss of affordable housing because of a natural disaster.

(d) Restrictions on loans in certain designated places.

(1) Initial loan applications will not be requested and final loan applications will not be closed for housing proposals in designated places where any of the following conditions exist:

(i) The Agency has selected another MFH proposal in the designated place for processing.

(ii) A previously funded Agency, the U.S. Department of Housing and Urban Development (HUD), low-income housing tax credit or other similar assisted MFH in the designated place has not been completed or has not reached projected occupancy levels.

(iii) Existing assisted MFH in the designated place is experiencing high vacancy levels.

(iv) A special note rent or other loan servicing tool is pending or in effect for other assisted housing in the designated place, or

(v) The need in the market area is for additional rental assistance and not additional rental units.

(2) Exceptions to the provisions in §3560.57(d)(1) may be made:

(i) When a group home is proposed for persons with disabilities in an area where the existing MFH is insufficient or unavailable for their needs; or

(ii) There is a compelling need for additional MFH, for example when the units that have been approved or are under development represent only a small portion of the total units needed in the community.

§3560.58 Site requirements.

(a) Location.

(1) New construction section 515 loans will be made only in designated places selected by the Agency in accordance with the requirements of §3560.57.

(2) Agency-financed MFH must be located in residential areas as part of established rural communities, except as permitted in §3560.58(b), and for farm labor housing units financed under sections 514 and 516, which may be developed in any area where a need for farm labor housing exists.

(3) Communities in which Agency-financed MFH is located must have adequate facilities and services to support the needs of tenants.

(4) Housing complexes will not be located in areas where there are undesirable influences such as high activity railroad tracks; adjacent to or near industrial sites; bordering sites or structures which are not decent, safe, or sanitary; or bordering sites which have potential environmental concerns such as processing plants. Sites which are not an integral part of a residential community and do not have reasonable access, either by location or terrain, to essential community facilities such as water, sewerage removal, schools, shopping, employment opportunities, medical facilities, may not be acceptable. Consistent with Federal law and Departmental Regulation, the Agency must conduct an environmental assessment and a civil rights impact analysis before a site can be accepted. Sites may be determined by the Agency to be unacceptable if any of the adverse conditions described in this paragraph exist.

(b) Structures located in central business areas. The Agency will consider financing construction or the purchase and substantial rehabilitation of an existing structure located in the central business area of a rural community. With prior consent from the Agency, a portion of such a structure may be designated for commercial use on a lease basis. RHS funds may not be used to finance any cost associated with the commercial space.

(c) Site development costs and standards. The cost of site development must be less than or comparable to the cost of site development at other available sites in the community and the site must be developed in accordance with 7 CFR part 1924, subpart C and any applicable standards imposed by a state or local government.

(d) Densities. Allowable site densities will be determined based on the following criteria:

(1) Compatibility and consistency with the community in which the MFH is located;

(2) Impact on the total development costs; and

(3) Size sufficient to accommodate necessary site features.

(e) Flood or mudslide-prone areas.

(1) The Agency will not approve sites subject to 100-year floods when non-floodplain sites exist. The environmental review process will assess the availability of a reasonable site outside the 100-year floodplain.

(2) Sites located within the 100 year floodplain are not eligible for federal financial assistance unless flood insurance is available through the National Flood Insurance Program (NFIP). The Agency will complete Federal Emergency Management Agency (FEMA) Form 81-93, Standard Flood Hazard Determination, to document the site's location in relation to the floodplain and the availability of insurance under NFIP.

§3560.59 Environmental requirements.

Under the National Environmental Policy Act, the Agency is required to assess the potential impact of the proposed action on protected environmental resources. Measures to avoid or mitigate adverse impacts to protected resources may require a change in the site or project design. Therefore, a site cannot be approved until the Agency has completed the environmental review requirements in accordance with 7 CFR part 1970. Likewise, the applicant should be informed that the environmental review must be completed and approved before the Agency can make a commitment of resources to the project. (Revised 04-01-16, SPECIAL PN.)

§3560.60 Design requirements.

(a) Standards. All Agency-financed MFH will be constructed in accordance with 7 CFR part 1924, subpart A and will consist of two or more rental units plus appropriate related facilities. Single family structures may be used for group homes and cooperative housing. Also, manufactured homes may be used to create MFH and single family housing originally financed through section 502 of the Housing Act of 1949 may be converted to MFH. Maintenance requirements are listed in §3560.103(a)(3).

(b) Residential design. All MFH must be residential in character, except as provided for in §3560.58(b), and must meet the needs of eligible residents.

(c) Economical construction, operation and maintenance. Taking into consideration life-cycle costs, all housing must be economical to construct, operate, and maintain and must not be of elaborate design or materials.

(1) Economical construction means construction that results in housing of at least average quality with amenities that are reasonable and customary for the community and necessary to appropriately serve tenants.

(2) Economical operating and maintenance means housing with operational and maintenance costs that allow a basic rent structure less than or consistent with conventional rents for comparable units in the community or in a similar community except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case may the rent exceed 150% of the comparable rent for conventional unit rent level.

(3) In meeting the Agency objective of economical construction, operation and maintenance, housing proposals must:

(i) Contain costs without jeopardizing the quality and marketability of the housing;

(ii) Employ life-cycle cost analyses acceptable to the Agency to determine the types of materials which will reduce overall costs by lowering operation and maintenance costs, even though their initial costs may be higher; and

(iii) Provide assurances that costs will be reduced when the Agency determines that housing costs are not economical. If assurances cannot be provided, funding may be withdrawn.

(4) The housing proposal will give maximum consideration to energy conservation measures and practices.

(d) Accessibility. All housing will meet the following accessibility requirements.

(1) For new construction of MFH, at least 5 percent of the units (but not less than one) must be constructed as fully accessible units to persons with disabilities. The Uniform Federal Accessibility Standards (UFAS) will be followed. Individual copies of these standards are available from the Architectural and Transportation Barriers Compliance Board, 1331 F Street, NW, Suite 1000, Washington, DC 20004-1111, Telephone: (202) 272-0080, TTY: (202) 272-0082, e-mail address: info@access-board.gov. When calculating how many accessible units are required, always round up to the next whole number to ensure the 5 percent requirement is met.

(2) For existing properties that do not have fully accessible units, the 5 percent requirement will apply when making substantial alterations as defined by UFAS. The UFAS defines substantial alteration as "alteration to any building or facility is to be considered substantial if the total cost for a twelve month period amounts to 50 percent or more of the full and fair cash value of the building * * *" UFAS further defines full and fair cash value as "the assessed valuation of a building or facility as recorded in the assessor's office of the municipality and as equalized at one hundred percent (100%) valuation, or the replacement cost, or the fair market value." The 5 percent rule will also apply to repair or renovation work on a single unit. For instance, if a unit is damaged by fire and extensive repair is necessary, to the extent possible the unit is to be converted to a fully accessible unit.

(3) The variety of bedroom quantities of fully accessible units will be comparable to the variety of bedroom quantities of units which are not fully accessible. Borrowers will not, however, be required to exceed the 5 percent requirement simply to have an accessible unit of each bedroom quantity. In addition, accessible units should be distributed throughout the complex so not to concentrate the units in one location.

(4) All MFH must meet:

(i) The accessibility requirements as contained in section 504 of the Rehabilitation Act of 1973;

(ii) The requirements of the Fair Housing Amendments Act of 1988;

(iii) The requirements of the Americans with Disabilities Act of 1990, as applicable; and

(iv) All other Federal, State, and local requirements. When architectural standards differ, the most stringent standard will be followed.

§3560.61 Loan security.

(a) General. Each loan made by the Agency will be secured in a manner that adequately protects the financial interest of the Federal Government throughout the period of the loan.

(b) Lien position.

(1) The Agency will seek a first or parity lien position on Agency-financed property in all instances. The Agency may accept a junior lien position if the Federal Government's interests are adequately secured.

(2) The Agency will seek a first or parity lien on revenue from rent; Agency, HUD, state or private rental subsidy payments; chattels; assignments; and operating and reserve accounts. The Agency will accept a junior lien position if the Federal Government's interests are adequately secured.

(c) Liability. Personal liability will be required of all individual borrowers. Personal liability will not be required for the members or stockholders of any corporation or trust or any partners in a limited partnership.

(d) Housing and land ownership. Applicants must own the MFH and related land for which the loan is being requested, or become the owner when the loan is closed or have a leasehold interest in the land. If an applicant is not the owner of the housing and the related land, the following conditions must be met prior to or at loan closing.

(1) A recorded mortgage on the improvements is given as collateral.

(2) The amount of the loan against the collateral does not exceed its estimated security value.

(3) The unexpired term of the lease on the date of loan closing is at least 50 percent longer than the term of the loan and rent charged for the lease does not exceed the rate being paid for similar leases in the area.

(4) The applicant's leasehold interest is not subject to summary foreclosure or cancellation.

(5) The lease permits:

(i) The Agency to foreclose the mortgage and to transfer the lease;

(ii) The Agency to bid at a foreclosure sale or to accept voluntary conveyance of the security in lieu of foreclosure;

(iii) The Agency to occupy the property, sublet the property, or sell the leasehold for cash or credit if the leasehold is acquired through foreclosure, if the Agency accepts voluntary conveyance in lieu of foreclosure, or if the borrower abandons the property; and

(iv) The applicant, in the event of default or inability to continue with the lease and the loan, to transfer the leasehold subject to the mortgage to a transferee that will assume the property ownership obligations.

§3560.62 Technical, legal, insurance, and other services.

(a) Legal services. Applicants must have written contracts for any legal services that are to be paid out of Agency loan funds.

(b) Title clearance. Applicants must obtain title clearance in accordance with the provisions of 7 CFR part 1927, subpart B applicable to title clearance, which would include title insurance or title opinion, unless the loan applicant is leasing the property or is an organization or an individual with special title or loan closing problems, in which case title clearance and related legal services will be obtained in accordance with procedures approved by the Agency.

(c) Architectural services. Applicants must obtain a written contract for architectural services in accordance with the provisions of 7 CFR part 1924, subpart A.

(d) Insurance. Applicants must have property and liability coverage at loan closing as well as flood insurance, if needed. Fidelity coverage must be in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. At a minimum, applicants must meet the property, liability, flood, and fidelity insurance requirements in §3560.105.

(e) Surety bonding. Applicants must comply with the surety bonding provisions of 7 CFR part 1924, subpart A.

§3560.63 Loan limits.

(a) Determining the security value. The security value for an Agency loan is the lesser of the total development cost (exclusive of any developer's fee as provided by paragraph (d)(2) of this section) or the housing project's security value as determined by an appraisal conducted in accordance with subpart P of this part, minus any prior or parity liens on the housing project. For purposes of determining security value:

(1) Total development cost must be calculated excluding costs not considered allowable under §3560.54(a), and excluding costs related to compliance with the Uniform Relocation Assistance and Real Property Acquisition Act of 1970.

(2) The appraisal, which will determine the market value, subject to restricted rents, will be obtained by the Agency and conducted in accordance with subpart P of this part.

(b) Limitations on loan amounts. The Agency will not make any loans without adequate security. The following limitations will be set on loan amounts:

(1) For all loan applicants who will receive benefits from the low-income housing tax credit program, the amount of Agency financing for the housing will not exceed 95 percent of the security value available for the Agency loan.

(2) For all loan applicants who will not receive low-income housing tax credit benefits and who are comprised solely of nonprofit organizations, consumer cooperatives, or state or local public agencies, the amount of the loan will be limited to the security value available for the Agency loan, plus the 2 percent initial operating capital and any necessary relocation costs incurred.

(3) For all other loan applicants who will not receive low-income housing tax credit benefits, the loan amount will be limited to no more than 97 percent of the security value available for the Agency loan.

(c) Equity contribution. Loan applicants, with the exception of nonprofit organizations, consumer cooperatives, or state or local public agencies who will not be receiving tax credits, must make an equity contribution from their own resources.

(1) Loan applicants who will receive benefits from the low-income housing tax credit program must make an equity contribution in the amount of 5 percent of the Agency loan. The maximum Agency loan will be determined in accordance with §3560.63(b).

(2) Loan applicants who will not receive benefits from the low-income housing tax credit program and are not nonprofit organizations, consumer cooperatives, or state or local public agencies must make an equity contribution in the amount of 3 percent of the Agency loan. The maximum Agency loan will be determined in accordance with §3560.63(b).

(d) Review of assistance from multiple sources. The Agency will analyze Federal Government and other assistance provided to any MFH project to establish the maximum loan amount and to assure that the assistance is not more than the minimum necessary to make the housing affordable, decent, safe, and sanitary to potential tenants.

(1) Determining minimum assistance. For purposes of determining minimum assistance, the total amount paid for builder's profit, overhead, and general requirements may not exceed 21 percent of the construction contract. Unless specified differently in a Memorandum of Understanding between the Agency and the state agency that allocates low-income housing tax credits, limits will be those specified in §3560.53(l).

(2) Developer's fee. While, in accordance with §3560.54(a)(9), payment of a developer's fee is not an eligible use of Agency loan funds, the Agency will include in total development costs a developer's fee paid from other sources when analyzing the Federal Government assistance to the housing. The Agency may recognize a developer's fee paid from other sources on construction or rehabilitation of up to 15 percent of the total development costs authorized for low-income housing tax credit purposes, or by another Federal Government program. Likewise for transfer proposals that include acquisition costs, the developer's fee on the acquisition cost may be recognized up to 8 percent of the acquisition costs only when authorized under a Federal Government program providing assistance. The developer's fee is not included in determining the Agency's maximum debt limit and loan amount.

(e) Limits on equity loans. For equity loans to avert prepayment, the amount of the Agency equity loan will be limited to no more than the difference between 90 percent of market value of the property when appraised as conventional unsubsidized MFH and all current unpaid balances. For information on appraisal issues, refer to subpart P of this part.

(f) Cost overruns.

(1) All applicants must agree in writing to provide funds at no cost to the housing and without pledging the housing as security to pay any cost for completing planned construction after the maximum debt limit is reached.

(2) After loan approval, the Agency will only approve cost increases for housing proposals involving new construction or major rehabilitation when the additional costs will not cause the limits specified in §3560.53(l) or the maximum debt limit to be exceeded and the cost increases were caused by:

(i) Unforeseen factors that are determined by the Agency to be beyond the borrower's control;

(ii) Design changes required by the Agency, state, or the local government; or

(iii) Financing changes approved by the Agency.

§3560.64 Initial operating capital contribution.

Borrowers are required to make an initial operating capital contribution to the general operating account in the amount of at least 2 percent of the total development cost or appraised value, whichever is less.

(a) Borrowers that are nonprofit organizations, consumer cooperatives, or state or local public agencies and are not receiving low-income housing tax credits, may use loan funds for their initial operating capital contribution. All other borrowers must fund the initial operating capital contribution from their own resources.

(b) Borrowers must provide to the Agency for approval a list of materials and equipment to be funded from the general operating account for initial operating expenses. As specified in §3560.304(b), initial operating capital may be used only to pay for approved budgeted expenses. If total initial operating expenses exceed 2 percent, the additional amount must be paid by the borrower from its own resources, except that borrowers meeting the provisions of §3560.64(a) who do not have sufficient resources for this purpose may request Agency assistance. Withdrawals from the reserve account will not be approved for such expenses.

(c) Borrowers must provide the Agency with documentation of their initial operating capital contribution deposited into the general operating account prior to the start of construction or loan closing, whichever comes first, and such funds thereafter, may only be used for authorized budgeted purposes.

(d) If the conditions specified in §3560.304(c) are met, funds contributed as initial operating capital may be returned to the borrower.

§3560.65 Reserve account.

(a) For new construction, to meet major capital expenses of a housing project, applicants must establish and fund a reserve account that meets the requirements of §3560.306. The applicant must agree to make monthly contributions to the reserve account pursuant to reserve account analysis which sets forth how the reserve account funds will meet the capital needs of the property over an acceptable 20 year period. The reserve account analysis is based on either a Capital Needs Assessment or life cycle cost analysis, provided and acceptable to Rural Development by the applicant. Adjustments may be made to the contribution amount at 5 or 10-year intervals, either through an updated Capital Needs Assessment or as part of the original life cycle cost analysis. The cost of conducting either a Capital Needs Assessment or life cost analysis will be paid for by the applicant. The cost of the initial Capital Needs Assessment or life cost analysis may be included in the loan financing.

(b) For ownership transfers or sales, the requirements of §3560.406 (d) (5) will be met.

(c) For other existing properties, at a minimum the borrower must agree to make monthly contributions to the reserve account at the rate of 1 percent annually of the amount of total development cost until the reserve account equals 10 percent of the total development cost.

§3560.66 Participation with other funding or financing sources.

(a) General requirements. The Agency encourages the use of funding or financing from other sources in conjunction with Agency loans. When the Agency is not the sole source of financing for MFH, the following conditions must be met.

(1) The Agency will enter into a participation (or intercreditor) agreement with the other participants that clearly defines each party's relationship and responsibilities to the others.

(2) The rental units that will serve tenants eligible for housing under the Agency's income standards must meet Agency standards and the number of units that will serve the Agency's tenants are at least equal to the units financed by the Agency.

(3) All rental units must be operated and managed in compliance with the requirements of the Agency and the other sources. To the extent these requirements overlap, the most stringent requirement must be met. The Agency may negotiate the resolution of overlapping requirements on a case-by-case basis; however, at a minimum, Agency requirements must be met.

(4) If the number of units subject to the LIHTC rent and income restrictions is greater than the number of units projected to receive Agency rental assistance (RA) or similar tenant subsidy, the market feasibility documentation must clearly reflect a need and demand by LIHTC income-eligible households financially able to afford the projected rents without such a subsidy for the units not receiving RA or similar tenant subsidy.

(b) Rental assistance. The Agency may provide rental assistance with MFH loans participating with other sources of funding under the following conditions:

(1) The Agency's loan equals at least 25 percent of the housing's total development cost.

(2) The rental assistance is provided only to those rental units where the basic rents do not exceed what basic rents would have been had the Agency provided full financing.

(3) The provisions of subpart F of this part are met.

(c) Security requirements. The security requirements of 3560.61 must be met for all Agency-financed MFH participating with other sources of funding.

(d) Reserve requirements. Reserve account requirements will be determined on a case-by-case basis, taking into consideration the reserve requirements of the other participating lenders, so that the aggregate fully funded reserve account is consistent with the requirements of §3560.65. Reserve requirements and procedures for reserve account withdrawals must be agreed upon by all lenders and included in the intercreditor or participation agreement.

(e) Design requirements. Housing and related facilities must be planned and constructed in accordance with 7 CFR 1924, subparts A and C. If housing includes non-Agency financed common facilities, the following conditions must be met:

(1) The non-Agency-financed common facility's operating and maintenance costs must be paid through collection of a user fee from residents who use the facility,

(2) The non-Agency-financed common facility must be designed and operated with appropriate safeguards for the health and safety of tenants, and

(3) The facility must be fully available and accessible to all tenants.

§3560.67 Rates and terms for section 515 loans.

Rates and terms for farm labor housing loans are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) Interest. Loans will be closed at the lower of the interest rate in effect at the time of loan approval or the interest rate that is in effect at time of loan closing.

(b) Interest credit. The Agency will provide interest credit to subsidize the interest on the Agency loan to a payment rate of 1 percent for all of the Agency's initial and subsequent loans.

(c) Amortization period and term.

(1) Except for manufactured housing, loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed 30 years from the date of loan. The Agency may make a loan to the borrower to finance the final payment of a loan in accordance with §3560.74.

(2) Loans for manufactured housing will be amortized and paid over a term not to exceed 30 years as specified in §3560.70(c).

§3560.68 Permitted return on investment (ROI).

(a) Permitted return. Borrowers operating on a limited profit basis will be permitted a return not to exceed 8 percent of their required initial investment determined at the time of loan approval in accordance with §3560.63(c).

(b) Calculation of permitted return. The permitted return will be based on the borrower's contributions from their own resources, which, when added to the Agency loan amount and all sources of funding or financing, do not exceed the security value of the MFH project as specified in §3560.63(a).

(1) Proceeds received by the borrower from the syndication of low-income housing tax credit and contributed to the MFH project may be considered funds from the borrower's own resources for the portion of the proceeds which exceeds:

(i) The allowable developer's fee determined by the state agency administering the low-income housing tax credit, and

(ii) The borrower's expected contribution to the transaction, as determined by the state agency administering the low-income housing tax credit.

(2) A building site contributed by the borrower will be appraised by the Agency to determine its market value. A return may not be allowed on the amount above the equity contribution required by §3560.63(c) if the market value as determined by the Agency, when added to the loan and grant amounts from all sources, exceeds the security value of the MFH project as specified in §3560.63(a).

(c) Return on additional investment. The initial investment may exceed the equity contribution required by §3560.63(c) and a return allowed on the investment if the additional return does not increase basic rents and rental assistance costs above what basic rents and rental assistance costs would have been with the Agency financing 95 or 97 percent of the total development cost.

(d) Compensation to nonprofit organizations. Although nonprofit organizations are not eligible to take a return on investment, with prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities, as described in §3560.303(b)(1)(ii).

§3560.69 Supplemental requirements for congregate housing and group homes.

(a) General. Congregate housing and group homes must be planned and developed in accordance with 7 CFR part 1924, subparts A and C.

(b) Design criteria. Congregate housing and group homes must be designed to accommodate all special services that will be provided.

(c) Services. Congregate housing and group home loan applicants, as part of their loan request, must submit a plan to make affordable services available to residents to assist the residents in living independently. The plan must address the availability of this assistance from service providers throughout the term of the loan.

(1) For congregate housing, the resident services plan must address how the following services will be provided or made available:

(i) One cooked meal per day, seven days per week;

(ii) Transportation to and from the property;

(iii) Assistance in housekeeping;

(iv) Personal services;

(v) Recreational and social activities; and

(vi) Access to medical services.

(2) For group homes, the resident services plan must address how access to the following services will be provided or made available:

(i) A common kitchen in which to prepare meals;

(ii) Transportation;

(iii) Nearby recreational and social activities which may be coordinated by the resident assistant, if applicable; and

(iv) Medical services as necessary.

(d) Necessary items. Borrowers must ensure items such as tables, chairs, and cookware necessary to furnish common areas are made available to congregate housing or group homes. The 2 percent initial operating capital may be used to purchase these items.

(e) Association with other organizations. Congregate housing and group homes may coordinate services or training with another organization, such as a workshop for the developmentally disabled. However, the housing facility must be a separate entity and not dependent on the other organization.

(f) Market feasibility documentation. Market feasibility documentation for congregate housing and group homes is subject to the following requirements:

(1) Must address the need for housing with services and include information concerning alternative service providers;

(2) Must contain demographic information pertaining to the population that is to be served by the congregate housing or group home project; and

(3) May consider an expanded market area that includes nondesignated places, but the facility must be located in a designated place.

(g) Rental assistance for group homes. A unit in a group home consists of a space occupied by a specific tenant household, which may be an apartment unit, a bedroom, or a part of a bedroom. Agency rental assistance will be made available to tenants sharing a unit so long as the total rent for the unit does not exceed conventional rents for comparable units in the area or a similar area.

§3560.70 Supplemental requirements for manufactured housing.

(a) Design requirements. Manufactured housing must meet the requirements of 7 CFR part 1924, subpart A applicable to manufactured housing.

(b) Eligible properties. The manufactured housing must include two or more housing units. The applicant will become the first owner purchasing the manufactured homes for purposes other than resale. The following exceptions may be made to this provision:

(1) A housing proposal may include the purchase of the real property with existing manufactured housing which will be redeveloped with the placement of new manufactured homes.

(2) A housing proposal may include the rehabilitation of existing manufactured housing only if the units to be rehabilitated are currently financed by the Agency. The proposal will include the results of the applicant's consultation with the manufacturer to determine if the proposed rehabilitation work will affect the structural integrity of the unit and, if so, the statement will include an explanation as to how.

(c) Terms. The maximum loan amount will be determined in accordance with the requirements of §3560.63. The amortization period and term of loans for manufactured housing will not exceed the lesser of the economic life of the housing being financed or 30 years.

(d) Security. A mortgage or deed of trust will be taken on the entire property purchased or improved with the loan. The encumbered property must be covered under a standard real estate title insurance policy or attorney's title opinion that identifies the housing as real property and insures or indemnifies against any loss if the manufactured home is determined not to be part of the real property. The property must be taxed as real estate by the jurisdiction where the housing is located if such taxation is permitted under applicable law when the loan is closed.

(e) Special warranty requirements. The general contractor or dealer-contractor, as applicable, must provide a warranty in accordance with the provisions of 7 CFR part 1924, subpart A.

(1) The warranty must establish that the manufactured homes, foundations, positioning and anchoring of the units to their permanent foundations, and all contracted improvements, are constructed in conformity with applicable approved plans and specifications.

(2) The warranty must include provisions that the manufactured homes sustained no hidden damage during transportation and, for double-wide units, that the sections were properly joined and sealed.

(3) The general contractor or dealer contractor must warrant that the manufacturer's warranty is in addition to and does not diminish or limit all other warranties, rights, and remedies that the borrower or lender may have.

(4) The seller of the manufactured homes must deliver to the borrower the manufacturer's warranty with an additional copy for RHS. The warranty must identify the units by serial number.

§3560.71 Construction financing.

(a) Construction financing plan. Prior to loan approval, applicants must submit to the Agency for its concurrence a plan for the construction financing and securing of the loan.

(b) Interim financing. Interim financing is required by the Agency for any construction, except as noted in paragraph (c) of this section.

(1) The Agency reserves the right to review and approve the interim financing arrangements proposed by the applicant.

(2) When interim financing is used, the Agency will obligate the funds and provide an interim financing letter to the lender that will confirm the procedures and conditions for the construction financing. The take-out loan will be closed and the interim lender paid off when the conditions of the interim financing letter have been met.

(3) The applicable provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(4) An environmental review in accordance with 7 CFR part 1970 must be completed prior to issuance of the interim financing letter. (Revised 04-01-16, SPECIAL PN.)

(c) Multiple advances. When interim financing is not available or when it is in the best interest of the Federal Government, the Agency may provide for multiple advances of the funds to cover the cost of construction.

(1) The Agency will review and approve the multiple advances proposed by the borrower.

(2) When multiple advances are used, the Agency will close the loan prior to any advancement of funds and the relevant provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(3) The loan check will be handled in accordance with 7 CFR part 1902, subpart A.

§3560.72 Loan closing.

(a) Requirements. Loans will be closed in accordance with 7 CFR part 1927, subpart B and any state supplements. In all cases, the borrower must:

(1) Provide evidence that an Agency-approved accounting system is in place;

(2) Execute a restrictive-use contract acceptable to the Agency that establishes the borrower's obligation to operate the housing for program purposes for the term of the Agency loan;

(i) For all section 514 loans, except as provided in §3560.621, made pursuant to a contract entered into on or after the effective date of this regulation, the following language will be included in the mortgage

and deed of trust: "The borrower and any successors in interest agree to use the housing for the purpose of housing people eligible for occupancy as provided in sections 514 and 516 of title V of the Housing Act of 1949, and Rural Housing Service regulations then in effect. The restrictions are applicable for a term of 20 years from the date on which the last loan was closed. No eligible person occupying the housing will be required to vacate nor any eligible person denied occupancy for housing prior to the close of such period because of a prohibited change in the use of the housing. A tenant or person wishing to occupy the housing may seek enforcement of this provision as well as the Government."

(ii) All other loans are subject to restrictive-use provisions as outlined in subpart N of this part.

(3) Provide evidence that construction financing arrangements are adequate when interim financing is going to be used;

(4) Provide evidence that all the funds from other sources as proposed in the application are available and that there have been no changes in the Sources and Uses Comprehensive Evaluation (SAUCE).

(5) Provide evidence of the title to all security required by the Agency;

(6) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be paid;

(7) Provide, in the case of interim financing, a dated and signed statement from the owner's architect certifying to substantial completion of the housing project;

(8) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be in accordance with the plans and specifications concurred in by the Agency;

(9) Provide evidence, if applicable, that the conditions of the interim financing letter have been met; and

(10) Attend a pre-occupancy conference with the Agency.

(b) Cost certification. In all cases, the borrower must report actual construction costs. Whenever the State Director determines it appropriate, and in all situations where there is an identity of interest as defined in 7 CFR 1924.4 (i), the borrower, contractor and any subcontractor, material supplier, or equipment lessor having an identity of interest must each provide certification as to the actual cost of the work performed in connection with the construction contract in accordance with 7 CFR part 1924, subpart A. The construction costs must also be audited in accordance with Governmental Auditing Standards, by a Certified Public Accountant (CPA). In some cases, the Agency will contract directly with a CPA for the cost certification. Funds that were included in the loan for cost certification and which are ultimately not needed because Agency contracts for the cost certification will be returned on the loan. Agency personnel will utilize exhibit M of 7 CFR part 1924, subpart A to assist in the evaluation of the cost certification process.

(c) Notification of loan cancellation. Loans may be canceled after approval and before loan closing. The Agency will notify all parties of the cancellation and the reasons for the cancellation in accordance with 7 CFR part 1927, subpart B.

§3560.73 Subsequent loans.

(a) Applicability. The Agency may make a subsequent loan to a borrower to complete, improve, repair, or make modifications to MFH initially financed by the Agency or for equity for preservation purposes. Loan requests to add units to comply with accessibility requirements may be processed as a subsequent loan; however, loan requests to add units to meet market demand will be processed as an initial loan request and must compete under the NOFA.

(b) Application requirements and processing. Upon receipt of a subsequent loan request, the Agency will inform the applicant what information is required based on the nature and purpose of the loan request. Subsequent loan requests do not have to compete for funding against initial loan proposals.

(c) Amortization and payment period. Subsequent loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed the lesser of the economic life of the housing or 30 years from the date of the loan.

(d) Equity contribution. Applicants for subsequent loans must make contributions on the loans in the same proportion as outlined in §3560.63(c). Loan applicants will not be given consideration for any increased equity value that the property may have since the initial loan.

(1) Excess initial investment on an initial loan may be credited toward the required investment on a subsequent loan.

(2) An initial operating capital contribution to the general operating account as described in §3560.64 is required for a subsequent loan approved under the conditions set in §3560.63(f) to complete housing construction but is not required for a subsequent loan to repair or improve existing housing.

(e) Environmental review requirements. Actions taken under this part must comply with the environmental review requirements in accordance with 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)

(f) Design requirements. All improvements, repairs, and modifications will be in accordance with 7 CFR part 1924, subparts A and C.

(g) Architectural services. The applicant must obtain architectural services when any of the following conditions exist:

(1) Enclosed space is being added,

(2) When required by state law, and

(3) When the Agency determines that the work being proposed requires architectural services.

(h) Restrictive-use requirements. Subsequent loans are subject to restrictive-use provisions as outlined in §3560.662(a) and borrowers must execute a restrictive-use contract in accordance with §3560.72(a)(2).

(i) Designation changes from rural to nonrural. If the designation of an area changes from rural to nonrural after the initial loan is made, a subsequent loan may be made only to make necessary improvements and repairs to the property or for equity when needed to avert prepayment.

(j) Agency's discretion. The Administrator may approve a subsequent loan in a place that is not on the list of designated places as a servicing action, for example, to replace units destroyed by a natural disaster.

§3560.74 Loan for final payments.

(a) Use. The Agency may finance final payments for borrowers holding existing loans for which the Agency approved an amortization period that exceeded the term of the loan.

(b) Requirements. The Agency may finance final payments if documentation regarding the market area shows that a need for low-income rental housing still exists for that area and one of the following conditions has been met.

(1) It is more cost efficient and serves the tenant base more effectively to maintain existing MFH than to build another property in the same location; or

(2) The MFH has been maintained to such an extent that it can be expected to continue providing affordable, decent, safe and sanitary housing for 20 years beyond the date of the loan to finance a final payment; and

(3) Funds are available.

(c) Term. The term of Agency loans to finance final payments will not exceed 20 years from the date of the initial loan final payment.

§§3560.75-3560.99 [Reserved]

§3560.100 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart C--Borrower Management and Operations Responsibilities

§3560.101 General.

This subpart sets forth borrower obligations regarding management and operations of multi-family housing (MFH) projects financed by the Agency. As noted in §3560.6, the borrower requirements listed in this subpart must be complied with by the borrower. The borrower may designate in writing a person to act as the borrower's authorized agent.

§3560.102 Housing project management.

(a) General. Borrowers hold final responsibility for housing project management and must ensure that operations comply with the terms of all loan or grant documents, Agency requirements and applicable local, state and Federal laws and ordinances.

Project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under Agency regulations. Any party not meeting these responsibilities may be subject to penalties. It is expected that only typical and reasonable expenses be incurred for the services rendered. Consequently, methods to inflate, duplicate, obscure, or failure to disclose the true nature and cost of work performed for the services rendered will cause the Agency to deny budget requests for the services or issue a demand for recovery and reimbursement for unauthorized actions.

(b) Management plan. Borrowers must develop and maintain a management plan for each housing project covered by their loan or grant. The management plan must establish the systems and procedures necessary to ensure that housing project operations comply with Agency requirements.

(1) At a minimum, management plans must address the following items:

(i) Maintenance systems, including procedures for routine maintenance, capital item repair and replacement, and effective energy conservation practices;

(ii) Personnel policies, job descriptions, staffing plans, training procedures for on-site staff. The Borrower will include specific dutiesand responsibilities of each property manager, site manager and caretaker;

(iii) Front-line management functions to be performed by off-site staff;

(iv) Plans and procedures for providing supplemental services including laundry, vending, and security;

(v) Plans for accounting, record keeping and meeting Agency reporting requirements;

(vi) Procurement procedures;

(vii) Rent and occupancy charge collection procedures, and procedures for requesting and implementing changes in rents, utility allowances, or occupancy charges;

(viii) Plans and procedures for marketing rental units and maintaining compliance with the Affirmative Fair Housing Marketing Plan in accordance with §3560.104;

(ix) Unit leases and leasing policies and procedures, including procedures for maintaining and purging waiting lists, determining applicant eligibility, certifying and recertifying income, tenant selection, and occupancy policies such as security deposit amounts, occupancy rules, termination of leases or occupancy agreements and eviction;

(x) Plans for allowing tenant participation in property operations and for fostering tenant relationships with management;

(xi) Procedures for applicant and tenant appeals; and

(xii) Describe how management will make known to tenants and applicants that management will provide reasonable accommodations under the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and regulations implemented there under at the borrower's expense unless to do so would cause an undue financial or administrative burden, how such requests are to be made, and who within management will have the authority to approve or disapprove a request for an accommodation.

(2) Loan or grant applicants must submit a management plan before the Agency will give final approval to the loan or grant application. The plan must address the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to monitor housing project performance.

(c) Management plan effective period. A management plan remains in effect as long as it accurately reflects housing project operations and the housing project is in compliance with the Agency requirements.

(1) Borrowers must submit an updated management plan to the Agency if operations change or are no longer consistent with the management plan on file with the Agency.

(2) When there are no changes in operations, borrowers must submit a certification to the Agency every 3 years stating that operations are consistent with the management plan and the plan is adequate to assure compliance with the loan and grant documents and Agency requirements or applicable local, state and Federal laws.

(3) If the Agency determines that operations are in compliance with Agency requirements, loan or grant agreements, or applicable local, state, and Federal laws, but are not consistent with the management plan, the Agency will require the borrower to:

(i) Revise the management plan to accurately reflect housing operations;

(ii) Take actions to ensure the management plan is followed; or

(iii) Advise the Agency in writing of the action taken.

(4) When a housing project is being transferred from one borrower to another, the transferee must submit a management plan that addresses the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to give final approval of the transfer.

(d) Housing projects with compliance violations. Upon receiving notice of compliance violations in accordance with §3560.354, borrowers must submit to the Agency:

(1) Revisions to the management plan establishing the changes in housing operations that will be made to restore compliance;

(2) If the borrower determines the compliance violations were due to a failure to follow the management plan, the borrower must certify to the Agency that the management plan is adequate to assure compliance with the applicable requirements of this part and submit a written description of the actions they will take to ensure the management plan is followed; or

(3) If the Agency discovers continued discrepancies between a management plan and housing project operations or compliance violations, the Agency may require the borrower to install a different management agent acceptable to the Agency as described in paragraph (e) of this section.

(e) Acceptable management agents. Borrowers must obtain Agency approval of the agent proposed to manage a housing project prior to entering into any formal agreement with the agent and prior to allowing the agent to assume responsibility for housing project operations. Borrowers that plan to self-manage a housing project also must receive Agency approval before assuming responsibility for housing operations.

(1) Borrowers must submit a written request for Agency approval of the proposed management agent at least 45 days prior to the date the agent is to assume responsibility for operations. This request must include a profile of the proposed management agent that provides sufficient information to allow the Agency to evaluate whether the agent is acceptable.

(2) The Agency will deny approval of any proposed management agent that cannot provide evidence of at least two years of experience and satisfactory performance in directing and overseeing the management of similar federally-assisted MFH.

(3) The Agency may issue approval of a management agent that does not meet the requirements of §3560.102(e)(2) if the management agent can provide evidence that indicates the ability to successfully manage a MFH project in accordance with Agency requirements.

(4) If a borrower enters into an agreement with a management agent or begins to self-manage prior to receiving Agency approval, the Agency will place the borrower in non-monetary default status and will require the borrower to immediately terminate the contract with the management agent.

(f) Self-management. Borrowers may self-manage a housing project but must receive Agency approval before assuming responsibility for housing operations. Borrowers that plan to self-manage must meet all requirements of §3560.102, except for paragraph (h) of this section.

(g) Identity-of-interest disclosure. Borrowers and management agents must disclose to the Agency all identity-of-interest relationships which they have with firms and must receive Agency approval to use such firms prior to entering into any contractual relationships with such entities that involve Agency funds.

(1) This disclosure must include any identity-of-interest relationships between:

(i) The borrower and the management agent;

(ii) The borrower or management agent and the providers of supplies and services to the housing project; and

(iii) The borrower or the management agent and employees of any of the above.

(2) Failure to disclose such relationships may subject the borrower, the management agent, and the other firms or employees found to have an identity of interest relationship to suspension, debarment, or other remedies available to the Agency.

(3) After disclosure of an identity-of-interest relationship:

(i) The borrower, management agent, and supplier of goods and services must provide documentation proving that use of identity-of-interest firms is in the best interest of the housing project;

(ii) Any supplier of goods and services must certify in writing to the Agency that the individual or organization has a viable, on-going trade or business qualified and licensed, if appropriate, to do the work for which a contract is being proposed;

(iii) The borrower, management agent, and supplier of goods and services must agree, in writing, that all records related to the housing project will be made available to the Agency, Office of the Inspector General (OIG), General Accountability Office (GAO), or a representative of the Agency, upon request; and

(iv) The Agency will deny the use of an identity-of-interest firm when the Agency determines such use is not in the best interest of the Federal Government or the tenants.

(h) Management agreement. Borrowers contracting with a management agent must execute a management agreement that establishes:

(1) The management agent's responsibility to comply with Agency requirements and local, state, and Federal laws;

(2) That the management fee is payable out of the housing project's general operating account consistent with the requirements of paragraph (i) of this section; and

(3) The Agency's authority to terminate the agreement for failure to operate the housing project in accordance with Agency requirements or local, state, or Federal laws.

(i) Management fees. Management fees will be an allowable expense to be paid from the housing project's general operating account only if the fee is approved by the Agency as a reasonable cost to the housing project and documented on the management certification. Management fees must be developed in accordance with the following:

(1) The management fee may compensate the management entity only for the specifically identified bundle of services to be provided to the housing project. Costs and services to be paid as part of the bundle of services include:

(i) Supervision by the management agent and its staff (time, knowledge, and expertise) of overall operations and capital improvements of the site.

(ii) Hiring, supervision, and termination of on-site staff.

(iii) General maintenance of project books and records (general ledger, accounts payable and receivable, payroll, etc.). Preparation and distribution of payroll for all on-site employees, including the costs of preparing and submitting all appropriate tax reports and deposits, unemployment and workers' compensation reports, and other IRS- or state-required reports.

(iv) Training provided to on-site staff at the project site.

(v) Preparation and submission of proposed annual budgets and negotiation of approval with the Agency, other governmental agencies and the borrowers.

(vi) Preparation and distribution of the Agency or other governmental agency forms and routine financial reports to borrowers.

(vii) Preparation and distribution of required year-end reports to the Agency or other governmental agency and borrowers.

(viii) Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.

(ix) Arranging for preparation by outside contractors of energy audits and utility allowance analysis. Implement appropriate changes.

(x) Preparation and implementation of Affirmative Fair Housing Marketing Plans as well as general marketing plans and efforts.

(xi) Review of tenant certifications and submission of monthly rental assistance requests, and overage. Submission of payments where required.

(xii) Preparation, approval, and distribution of operating disbursements; oversight of project receipts; and reconciliation of deposits.

(xiii) Overhead of management agent, including:

(A) Establish, maintain, and control an accounting system sufficient to carry out accounting supervision responsibilities.

(B) Maintain agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, the Agency or other governmental agency and with the borrowers.

(C) Postage expenses related to the normal responsibility for mailings to the properties, the Agency or other governmental agency, the tenants, the vendors, and the owners.

(D) Expense of telephone and facsimile communication to the properties, tenants, the Agency or other governmental agency, and the borrowers.

(E) Direct costs of insurance (fidelity bonds covering central office staff, computer and data coverage, general liability, etc.) directly related to protection of the funds and records of the borrower.

(F) Central office staff training and ongoing certifications.

(G) Maintenance of all required profession and business licenses and permits. (This does not include project site office permits or licenses.)

(H) Insurance coverage for agent's office and operations (Property, Auto, Liability, E&O, Casualty, Workers Compensation, etc.)

(I) Travel of agent staff to the properties for on-site inspection, training, or supervision activities.

(J) Agent bookkeeping for their own business.

(xiv) Attendance at meetings (including travel) with tenants, owners, and the Agency or other governmental agency.

(xv) Development, preparation, and revision of management plans or agreements.

(xvi) Coordination of U.S. Department of Housing and Urban Development (HUD) certifications or vouchers with tenants, including all reporting to all pertinent agencies and borrowers.

(xvii) Directing the investment of project funds into required accounts.

(xviii) Maintenance of bank accounts and monthly reconciliations.

(xix) Preparation, request for, and disbursement of borrower's initial operating capital (for new projects) as well as administration of annual owner's return on investment.

(xx) Account maintenance, settlement, and disbursement of security deposits.

(xxi) Working with third party auditors for initial set-up of audits and annually thereafter for audit preparation and review. Assistance with supplemental letters and preparation of Agency financial reports or other governmental agency reports.

(xxii) Storage of records and adherence to records retention requirements.

(xxiii) Assist on-site staff with tenant relations and problems. Provide assistance to on-site staff in severe actions (eviction, death, insurance loss, etc.).

(xxiv) Oversight of general and preventive maintenance procedures and policies.

(xxv) Development and oversight of asset replacement plans.

(xxvi) Oversight of preparation of section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and section 504 requirements.

(xxvii) Reporting to general and limited partners and State agencies for Low Income Housing Tax Credit (LIHTC)-compliance purposes.

(2) Management fees may consist of a base per occupied unit fee and add-on fees for specific housing project characteristics. Management entities may be eligible to receive the full base per occupied unit fee for any month or part of a month during which the unit is occupied.

(i) Periodically, the Agency will develop a range of base per occupied unit fees that will be paid in each state. The Agency will develop the fees based on a review of housing industry data. The final base for occupied unit fees for each state will be made available to all borrowers.

(ii) Periodically, the Agency will develop the amount and qualifications to receive add-on fees. The final set of qualifications will be made available to all borrowers.

(3) Allowable Administrative Expenses.

(i) Identifying the Type of Administrative Expense. Management Plans and Agreements must describe if administrative expenses are to be paid from the management fee or paid for as a project cost.

(A) A management plan is required for all projects. The management plan should describe administrative expenses paid from management agent fees or project operations. The management plan should provide job descriptions for the site manager, the management agent and other personnel. It is important that these documents accurately reflect the duties being performed by the various personnel. The management plan must meet the standards set out in this rule.

(B) A task list should be used to identify which services are included in the management fee, which services are included in project operations, and which are pro-rated along with the methodology used to pro-rating of expenses between management agent fees and project
operations. Some property responsibilities are completed at the property and some offsite. Agent responsibilities may be performed at the property, the management office, or at some other location.

(C) Disputes may arise as to who performs certain services. The management plan and job descriptions should normally provide sufficient clarity to avoid or resolve any such disputes; however, sometimes clarifications and supporting materials may be required to resolve disputes. The decision must be made based on the most complete evaluation of the facts presented.

(ii) Allowable Administrative Expenses. Payroll related administrative expenses are allowable expenses. Postage expense to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, and report submittals to various regulatory authorities for the managed property are allowable project expenses no matter what location or point of origin the mail is generated. Photocopying or printing expense related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters are allowable project expenses no matter what location or point of origin the work is performed including outsourcing the work to a professional printer. Correspondence or reports required for record retention or project compliance are allowable project expenses. The cost or expense of equipment and any related equipment service contract is a management agent direct expense, unless the machine becomes the property of the project after purchase.

(iii) Determining if Expenses are Reasonable. Generally, expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes. If such value is not apparent, the service or expense should be examined.

(A) Administrative expenses for project operations exceeding 23 percent, or those typical for the area, of gross potential basic rents and revenues (i.e., referred to as gross potential rents in industry publications) highlight a need for closer review for unnecessary expenditures. Budget approval is required and project resources may not always permit an otherwise allowable expense to be incurred if it is not fiscally prudent in the market.

(B) Excessive administrative expenses can result in inadequate funds to meet other essential project needs, including expenditures for repair and maintenance needed to keep the project in sound physical condition. Actions that are improper or not fiscally prudent may warrant budget disapproval and/or a demand for recovery action.

(4) Unallowable Administrative Expenses.

(i) Certain expenses are not allowable such as legal fees, association dues, bonuses or monetary performance awards, parties, computer hardware and some software, and telephone purchases.

(ii) It is inappropriate to charge for legal services to represent any interest other than the borrower's interest (i.e., representing a general partner or limited partner to defend their individual owner interest is not allowable).

Where there is no finding of a borrower's fault, commercially reasonable legal expenses and costs for defending or settling lawsuits (without admission of liability) are allowable.

(iii) Charging for payment of penalties, including opposition legal fees resulting from an award finding improper actions on the part of the owner or management agent is generally an inappropriate project expense. The party responsible generally pays such expenses for violating the standards or by their insurance carriers.

(iv) Association dues to be paid by the project should only be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.

(v) It is inappropriate for the project to pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(vi) Billing the project for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff are also inappropriate.

(vii) It is inappropriate to bill the project for computer hardware, some software, and internal connections that are beyond the scope and size reasonably needed for the services supplied (i.e., purchasing equipment or software for use by a site manager that is clearly beyond that needed to support project operations). Note that computer learning center activities benefiting tenants are not covered in this prohibition.

(viii) It is inappropriate to bill the project for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(j) Management certification.

(1) As a condition of approval of the management agent and the management fee, the borrower and the management agents must execute an Agency-approved certification establishing an allowable management fee to be paid out of the housing project's general operating account and certifying that:

(i) The borrower and management agent agree to operate the housing project in accordance with the management plan;

(ii) The borrower and the management agent will comply with Agency requirements, loan or grant agreements, applicable local, state and Federal laws and ordinances, and contract obligations, will certify that no payments have been made to anyone in return for awarding the management contract to the management agent, and will agree that such payments will not be made in the future;

(iii) The borrower and the management agent will comply with Agency notices or other policy directives that relate to the management of the housing project;

(iv) The management agreement between the borrower and management agent complies with the requirements of this section;

(v) The borrower and the management agent will comply with Agency requirements regarding management fees as specified in paragraph (i) of this section, and allocation of management costs between the management fee and the housing project financial accounts specified in §3560.302(c)(3);

(vi) The borrower and the management agent will not purchase goods and services from entities that have an identity-of-interest (IOI) with the borrower or the management agent until the IOI relationship has been disclosed to the Agency according to paragraph (g) of this section, not denied by the Agency under paragraph (d)(3) of this section, and it has been determined that the costs are as low as or lower than arms-length, open-market purchases; and

(vii) The borrower and the management agent agree that all records related to the housing project are the property of the housing project and that the Agency, OIG, or GAO may inspect the housing records and the records of the borrower, management agent, and suppliers of goods and services having an IOI with the borrower or with a management agent acting as an agent of the borrower upon demand.

(2) A certification will be executed each time a management agent is proposed and a management agreement is executed or renewed. Any amendment to a management certification must be approved by the Agency and the borrower.

(k) Procurement. The borrower and the agents of the borrower must obtain contracts, materials, supplies, utilities, and services at a reasonable cost and seek the most advantageous terms to the housing project. Any discounts, rebates, fees, proceeds, or commissions obtainable with respect to purchases, service contracts, or other transactions must be credited to the housing project.

(l) Electronic Submission of Data to Agency. For properties with eight or more housing units, the Agency may specify that borrowers submit information required by this part electronically.

§3560.103 Maintaining housing projects.

(a) Physical maintenance.

(1) The purposes of physical maintenance are the following:

(i) Provide decent, safe, and sanitary housing; and

(ii) Maintain the security of the property.

(2) Borrowers are responsible for the long-term, cost-effective preservation of the housing project.

(3) At all times, borrowers must maintain housing projects in compliance with local, state and federal laws and regulations and according to the following Agency requirements for affordable, decent, safe, and sanitary housing. Agency design requirements are discussed in §3560.60. The Agency acknowledges that property maintenance is an ongoing process and will not penalize borrowers for less than 100 percent compliance as long as it is evident that the borrower is striving to achieve the standards listed in this paragraph. In addition, the Agency understands that although its multifamily housing portfolio is relatively homogeneous, no one standard is appropriate for all properties.

(i) Utilities. The housing project must have an adequate and safe water supply, a functional and safe waste disposal system, and must be free of hazardous waste material.

(ii) Drainage and erosion control. The housing project must have drainage that effectively protects the housing project from water damage from standing water and erosion. Units, basements, and crawl spaces must be free of water seepage.

(iii) Landscaping and grounds. The housing project must be landscaped attractively. Lawns, plants and shrubs must be maintained and must allow air to windows, vents, and sills. Recreation areas must be maintained in a safe and clean manner and trash collection areas must be adequately sized, screened, and maintained.

(iv) Drives, parking services and walks. The housing project must have drives, parking lots, and walks that are free of holes and deterioration. Walks with changes in height between slabs of approximately \1/2\ inch or greater will be considered unacceptable.

(v) Exterior signage. All signs at the housing project, including those related to the housing project name, buildings, parking spaces, unit numbers and other informational directions must be visible and well-kept. Sign requirements must conform to §3560.104(d).

(vi) Fences and retaining walls. The housing project must have fence lines that are free of trash, weeds, vines, and other vegetation. Fences must be free of holes and damaged or loose sections. The bases of all retaining walls must be erosion free and drainage weep holes must be cleaned out to prevent excessive pressure behind the retaining wall.

(vii) Debris and graffiti. The housing project, including common areas, must be free of trash, litter, and debris. Public walkways, walls of buildings and common areas must be free of raffiti.

(viii) Lighting. The housing project must have functional exterior lighting and functional interior lighting in common areas which permits safe access and security.

(ix) Foundation. The housing project must have a foundation that is free of evidence of structural failure, such as uneven settlement indicated by horizontal cracks or severe bowing of the foundation wall. Structural members must not have evidence of rot or insect or rodent infestation.

(x) Exterior walls and siding. The housing project must have walls that are free from deterioration which allows elements to infiltrate the structure, eaves, gables, and window trim that are free from deterioration, exterior wall coverings that are intact, securely attached, and in good condition. Brick veneers must be free of missing mortar or bricks.

(xi) Roofs, flashing, and gutters. The housing project must have gutters and downspouts, where appropriate for climatic conditions, that are securely attached, clean, and finished or painted properly with splash blocks or extenders that direct water flow away from the building. The housing project must have a roof that is free of leaks, defective covering, curled or missing shingles and which is not sagging or buckling. Fascia and soffits must be intact.

(xii) Windows, doors, and exterior structures. The housing project must have screens that are free of tears, breaks and rips and windows that are unbroken. Window thermopane seals must be unbroken and caulking on the exterior of windows and doors must be continuous and free of cracks. Doors must be weather tight, free of holes, and provide security with functional locks. Porches, balconies, and exterior stairs must be free of broken, missing, or rotting components.

(xiii) Common area accessibility. The housing project must have accessible, designated handicapped parking spaces with handicapped space signs properly posted. Common areas must be accessible through walks, ramps, porches, and thresholds. The laundry room must have accessible appliances and mailboxes must be at an accessible level. Elevators or mechanical lifts must be functional and kept in good repair.

(xiv) Common area signage. The following must be posted in a conspicuous place in a common area: "Justice for All" poster, HUD equal housing opportunity poster including the Spanish version if there are Hispanic Limited English Proficiency tenants or applicants, current affirmative fair housing marketing plan, the tenant grievance and appeal procedure, housing project occupancy rules, office hours and phone number, and emergency hours and phone number.

(xv) Flooring. If a housing project has carpeting, the carpet must be clean, without excessive wear, and seams that are secure and stretched properly. If the housing project has resilient flooring, the flooring must be clean, unstained, free of tears and breaks, and seams that are secure.

(xvi) Walls, floors, and ceilings. The housing project must have walls, floors, and ceilings that are free of holes, evidence of current water leaks, and free of material that appears in danger of falling. The housing project must have wallboard joints that are secure and free of cracks.

(xvii) Doors and windows. The housing project must have doors that are free of holes, secure, unbroken and easily operable hardware, deadbolt locks which are in place and secure, and, if doors are metal, free of rust. The housing project must have windows which are easily operated, free of bent blinds or torn curtains, and window interiors must be free of evidence of moisture damage.

(xviii) Electrical, air conditioning and heating. The housing project must have heating and cooling units that are free of bare wires and which are functioning properly, including thermostats. The housing project must not have uncovered outlets or other evident safety hazards, switches which work improperly, or light fixtures which are broken and inoperable.

(xix) Water heaters. The housing project must have water heaters which are operating properly, free of leaks, supply adequate hot water, and are fitted with temperature and pressure relief valves.

(xx) Smoke alarms. The housing project must have smoke alarms which are properly located according to local code and which operate properly.

(xxi) Emergency call system. If a housing project has an emergency call system, the switches must be located in the bathroom and bedroom, furnished with a pull cord, with the down position set to "ON", and must operate properly.

(xxii) Insect or vermin infestation. The housing project must have all units free of visible signs of insects or rodents and must be free of signs of insect or rodent damage.

(xxiii) Range and range hood. The housing project must have range units in which all elements are operable, electrical connections are secure and insulated, doors and drawers which are secure, control knobs and handles which are in place and secure, and housing which is sound and the finish is free of chips, damage, or signs of rust. The range hood fan and light must be operable.

(xxiv) Refrigerator. The housing project must have refrigerators in which the cooler and freezer are operating properly, the shelves and door containers are secure and free of rust, door gaskets are in good condition and functioning properly, and the housing is sound and the finish is free of chips, damage, or signs of rust.

(xxv) Sinks. The housing project must have sinks in which the fittings work properly and are free of leaks, plumbing connections under the cabinet which are free of leaks, the finish is free of chips, damage, or signs of rust, the strainer is in good condition and in place, and which are secured to a wall, counter, or vanity top.

(xxvi) Cabinets. The housing project must have cabinets and vanities which are secure to walls or floor and have faces, doors, and drawer fronts that are in good condition and free of breaks and peeling. Shelving must be in place, fastened securely, and free of warps. The housing project must have counter tops which are secure and free of burn marks or chips, bottoms under sinks which are free of evidence of warping, breaks, or being water soaked. Kitchen counter, vanity tops, and back splashes must be properly caulked.

(xxvii) Water closets. The housing project must have the base of the water closets at the floor properly caulked. The tanks must be free of cracks or leaks and have a lid which fits and is in good condition. The seats must be secure and in good condition, and the flushing mechanisms must be in good condition and operating properly. The stools must be free of cracks and breaks and be securely fastened to the floor.

(xviii) Bathtub and shower stalls. The housing project must have tubs or shower stalls which are free of cracks, breaks, and leaks, and a strainer in good condition and in place. The housing project must have walls and floors of the bathtubs which are properly caulked, tops and sides of shower stalls must be properly caulked, and the finish is free of chips, damage, or signs of rust.

(4) The Agency expects that upon discovery of a condition not in compliance with the standards listed in this section that the borrower will remedy the situation in a timeframe required by the Agency. The Borrower must provide documentation and justification for any failure to meet such timeframe. Properties with deficiencies in the process of being addressed will not be deemed to be out of compliance unless there are so many deficiencies that it would result in a declaration of substantial noncompliance and call into questions the viability of the property and the effectiveness of the borrower's maintenance program. Failure to make such corrections or repairs constitutes a non-monetary default under §3560.452(e).

(b) Maintenance systems. Borrowers must establish the following maintenance systems and must describe these systems in their management plan.

(1) A system for routine maintenance, including:

(i) Regular maintenance tasks that can be prescheduled or planned; and

(ii) Tasks performed on a regular basis to maintain compliance with the standards established in paragraph (a)(3) of this section.

(2) A system for responsive maintenance including:

(i) A process for responding to requests for maintenance from tenants;

(ii) A process for responding to unexpected malfunctions of equipment or damages to building systems such as a furnace breakdown or a water leak; and

(iii) A ‘work order’ process for managing and tracking responses to maintenance requests and the performance of maintenance tasks.

(3) A system for preventive maintenance including:

(i) Maintenance of mechanical systems, building exteriors, elevators, and heating and cooling systems which require specially trained personnel; and

(ii) Maintenance that supports energy-efficient operation of the housing project.

(4) A system for correcting deficiencies identified by periodic inspections, which must include:

(i) A move-in inspection;

(ii) A move-out inspection; and

(iii) An annual inspection of occupied units.

(c) Capital budgeting and planning.

(1) Borrowers must develop a capital budget as part of their annual housing project budget required under §3560.303. The capital budget must include anticipated expenditures on the long-term capital needs of the housing project to assure adequate maintenance and replacement of capital items.

(2) If the borrower requests an increase in the project's reserve for replacement account, the borrower must have a capital needs assessment prepared and submitted to the Agency to reflect anticipated needs of the housing project for replacement of capital equipment and systems. The cost for preparation of a capital needs assessment will be approved by the Agency as an eligible housing project expense provided the capital needs assessment is reasonable in cost and meets Agency requirements.

(3) [Reserved].

(4) As a part of the annual budget process, borrowers may request an increase in the amount to be contributed and held in the housing project reserve account to fund the needs identified in an Agency-approved capital needs assessment.

(5) At any time, borrowers may request and the Agency may approve amendments to loan or grant documents to increase the amount of funds to be contributed and held in a reserve account to cover the cost of capital improvements based on the needs identified in an Agency approved capital needs assessment. Borrowers must assure improvements are performed as specified in the capital needs assessment.

§3560.104 Fair housing.

(a) General. Borrowers must comply with the requirements of the Fair Housing Amendments Act of 1988, and this section to meet their fair housing responsibilities.

(b)Affirmative Fair Housing Marketing Plan.

(1) Borrowers with housing projects that have four or more rental units must prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M.

(2) Loan or grant applicants must submit an AFHMP for Agency approval prior to loan closing or grant approval. Plans must be updated by the borrower whenever components of the plan change.

(3) Borrowers must post the approved AFHMP for public inspection at the housing project site, rental office, or at any other location where tenant applications for the project are received.

(4) When developing the plan, the following items must be considered by the borrower:

(i) Direction of marketing activities. The plan should be designed to attract applications for occupancy from all potentially eligible groups of people in the housing marketing area, regardless of race, color, religion, sex, age, familial status, national origin, or disability. The plan must show which efforts will be made to reach very low-income or low-income groups who would least likely be expected to apply without special outreach efforts.

(ii) Marketing program. The applicant or borrower should determine which methods of marketing such as radio, newspaper, TV, signs, etc., are best suited to reach those very low-income or low-income groups who are in the market area but who are least likely to apply for occupancy. Marketing must not rely on "word of mouth" advertising.

(A) Advertising.

(1) Frequency. The borrower should advertise availability of housing units in advance of their availability to allow time to receive and process applications. Advertising by newsprint or electronic media must occur at least annually to promote project visibility, even if there is an adequate waiting list.

(2) Posters, brochures, etc. Any radio, TV or newspaper advertisement, pamphlets, or brochures used must identify that the complex is operated on an equal housing opportunity basis. This must be done through the use of the equal housing opportunity statement, slogan, or logo type. Copies of the proposed material must be sent when requesting approval of the plan.

(B) Community contacts. Community leaders and special interest groups such as community, public interest, religious organizations, and organizations for the disabled must be contacted. Owners and managers of projects with fully accessible apartments must adopt suitable means to ensure that information regarding the availability of accessible units reaches eligible persons with disabilities. In addition, owners and managers of elderly housing must ensure that information regarding eligibility reaches people who are less than 62 years old but who are eligible because they are disabled. Appropriate contacts are with physical rehabilitation centers, hospitals, workshops for the disabled, commissions on aging, and veterans' organizations.

(C) Rental staff. All staff persons responsible for renting the units must have had training provided on Federal, state, and local fair housing laws and regulations and in the requirements of fair housing marketing and in those actions necessary to carry out the marketing plan. Copies of instructions to the staff regarding fair

housing and a summary of the training they have received must be attached to the plan when requesting approval.

(iii) Marketing records. Records must be maintained by the borrower reflecting efforts to fulfill the plan. These records will be reviewed by the Agency during civil rights compliance reviews. Plans will be updated as needed.

(c) Accommodations and communication. The borrower must take appropriate steps to ensure effective communication with applicants, tenants, and members of the public with disabilities. At a minimum, the following steps must be taken:

(1) Furnish appropriate auxiliary aids (electronic, mechanical, or personal assistance) where necessary, to afford an individual with disabilities an equal opportunity to participate in and enjoy the benefits of Agency financed housing.

(i) In determining what auxiliary aids are necessary, the borrower must give primary consideration to the requests of individuals with disabilities.

(ii) The borrower is not required to provide individually prescribed devices, readers for personal use or study, or other devices of a personal nature.

(2) Where a borrower communicates with applicants and tenants by telephone, telecommunication devices for deaf persons or equally effective communication systems must be available for use.

(3) The borrower must implement procedures to ensure that interested persons, including persons with impaired vision or hearing, can obtain information concerning the existence and location of accessible services, activities, and facilities in the housing project and community.

(4) The borrower is required to provide reasonable accommodations at the project's expense unless doing so would result in undue financial or administrative burden on the project. Examples of reasonable accommodations may include such items as the installation of grab bars, ramps, and roll-in showers. Reasonable accommodations may also include the modification of rules or policies such as permitting a disabled tenant to have a two-bedroom unit to accommodate a resident assistant or to permit a disabled tenant to have a companion animal. The decision whether the requested accommodation is reasonable or unreasonable or whether to provide the accommodation would cause an undue financial or administrative burden lies with the borrower and would be for the borrower to defend should a complaint subsequently be filed. Borrowers may wish to consult with their legal counsel prior to denying a request. If the borrower takes the position that providing an accommodation would cause an undue financial or administrative burden, the borrower must permit the tenant to make reasonable modifications at the tenant's expense. Requests for reasonable accommodations must be handled in accordance with the management plan.

(d) Housing sign requirements.

(1) A permanent sign identifying the housing project is required for all housing projects approved on or after September 13, 1977. Permanent signs are recommended for all housing projects approved prior to September 13, 1977. The sign must meet the following requirements:

(i) Must be located at the primary site entrance and be readable and recognizable from the roadside;

(ii) Must be located near the site manager's office when the housing project has multiple sites and portable signs must be placed where vacancies exist at other site locations of a “scattered site” housing project;

(iii) May be of any shape;

(iv) Must be not less than 16 square feet of area for housing projects with 8 or more rental units (smaller housing projects may have smaller signs);

(v) Must be made of durable material including its supports;

(vi) Must include the housing project name;

(vii) Must show rental contact information including but not limited to the office location of the housing project and a telephone number where applicant inquiries may be made;

(viii) Must show either the equal housing opportunity logotype (the house and equal sign, with the words equal housing opportunity underneath the house); the equal housing opportunity slogan “equal housing opportunity”; or the equal housing opportunity statement, “We are pledged to the letter and spirit of U.S. policy for the achievement of equal housing opportunity throughout the nation. We encourage and support an affirmative advertising and marketing program in which there are no barriers to obtaining housing because of race, color, religion, sex, handicap, familial status, or national origin.” If the logotype is used, the size of the logo must be no less than 5 percent of the total size of the project sign.

(ix) May display the Agency or Department logotype; and

(x) Must comply with state and local codes.

(2) Accessible parking spaces must be reserved for individuals with disabilities by a sign showing the international symbol of accessibility. The sign must be mounted on a post at a height that is readily visible from an occupied vehicle. In snow areas, the sign must be visible above piled snow. If there is an office, the designated parking space must be van accessible.

(3) When the continuous unobstructed ingress or egress disabled accessibility route to a primary building entrance is other than the usual or obvious route, the alternate route for disabled accessibility must be clearly marked with international accessibility symbols and directional signs to aid a disabled person's ingress or egress to the building, through an accessible entrance, and to the accessible common use and public and living areas.

§3560.105 Insurance and taxes.

(a) General. Borrowers must purchase and maintain property insurance on all buildings included as security for an Agency loan. Also, borrowers must furnish fidelity coverage, liability insurance, and any other insurance coverage required by the Agency in accordance with this paragraph to protect the security of the asset. Failure to maintain adequate insurance coverage or pay taxes may lead to a non-monetary default under §3560.452(c).

(b) General insurance requirements. All insurance policies must meet the requirements established by the loan documents and this section.

(1) At loan closing, prior to loan approval, applicants must provide documentary evidence that insurance requirements have been met. The borrower must maintain insurance in accordance with requirements of their loan or grant documents and this section until the loan is repaid

(2) Insurance companies must meet the requirements of paragraph (e) of this section.

(3) Insurance coverage amount, terms, and conditions must meet the requirements of paragraph (f) of this section.

(4) The Agency must be named as loss co-payee on all property insurance policies where it holds first lien position. The Agency must be named as an additional insured if its lien position is other than first.

(c) Borrower failure or inability to meet insurance requirements. The Agency will take the following actions in cases where a borrower is unwilling or unable to meet the Agency's insurance requirements:

(1) The Agency will obtain insurance for Agency financed property if the borrower fails to do so. If borrowers refuse to pay the insurance premium, the Agency will pay the insurance premium and charge the premium payment amount to the borrower's Agency account and will place the borrower in default as described in §3560.452(c).

(2) If borrowers habitually fail to pay premiums in a timely manner, the Agency will require borrowers to escrow amounts appropriate to pay insurance premiums.

(3) If insurance that meets the Agency's specified requirements is not available (e.g. flood or hurricane insurance), the Agency may accept the insurance policy that most nearly conforms to established requirements.

(4) If the best insurance policy a borrower can obtain at the time the borrower receives the loan or grant contains a loss deductible clause greater than that allowed by paragraph (f)(8) of this section, the insurance policy and an explanation of the reasons why more adequate insurance is not available must be submitted to the Agency prior to loan or grant approval.

(d) Credits, refunds, or rebates. Borrowers must credit any refund or rebate from an insurance company to the project's general operating account or reserve account.

(e) Insurance company requirements. All insurers, insurance agents, and brokers must meet the following requirements:

(1) Be licensed or authorized to do business in the state or jurisdiction where the housing project is located; and

(2) Be deemed reputable and financially sound as determined by the Agency.

(f) Property insurance. The following conditions apply to property insurance purchased for Agency-financed housing projects.

(1) At a minimum, borrowers must obtain the following types of property insurance:

(i) Hazard insurance. A policy which generally covers loss or damage by fire, smoke, lightning, hail, explosion, riot, civil commotion, aircraft, and vehicles. These policies may also be known as "Fire and Extended Coverage," "Homeowners," "All Physical Loss," or "Broad Form" policies.

(ii) Flood insurance. This coverage is required for properties located in Special Flood Hazard Areas (SFHA) as defined in 44 CFR part 65, as determined by the Federal Emergency Management Agency (FEMA).

(iii) Builder's risk insurance. A policy that insures dwellings under construction or rehabilitation.

(iv) Elevators, boiler, and machinery coverage. This coverage is required for properties that operate elevators, steam boilers, turbines, engines, or other pressure vessels.

(2) Other types of insurance that the Agency may require:

(i) Windstorm Coverage.

(ii) Earthquake Coverage.

(iii) Sinkhole Insurance or Mine Subsidence Insurance.

(3) For property insurance, the minimum coverage amount must equal the "Total Estimated Reproduction Cost of New Improvements," as reflected in the housing project's most recent appraisal. At a minimum, property insurance coverage must be adequate to cover the lesser of the depreciated replacement value of essential buildings or the unpaid balance of all secured debt, unless such coverage is financially unfeasible for the housing project.

(i) If the cost of the minimum level of property insurance coverage exceeds what the housing project can reasonably afford, the borrower, with Agency concurrence, must obtain the maximum amount of property insurance coverage that the housing project can afford.

(ii) If the coverage amount is less than the depreciated replacement value of all essential buildings, borrowers must obtain coverage on one or more of the most essential buildings, as determined by the Agency.

(iii) When required, the coverage amount for flood insurance must equal the outstanding loan balance or the maximum coverage allowed by FEMA's "National Flood Insurance Program."

(4) Except for flood insurance, property insurance is not required if the housing project:

(i) Has a depreciated replacement value of $2,500 or less; or

(ii) Is in a condition which the Agency determines makes insurance coverage not economical.

(5) Policies for several buildings or properties located on noncontiguous sites are acceptable if the insurer provides proof that each secured building or property related to the housing project is as fully protected as if a separate policy were issued.

(6) Borrowers must notify the Agency and their insurance company agents of any loss or damage to insured property and collect the amount of the loss.

(7) When the Agency is in the first lien position and an insurance settlement represents a satisfactory adjustment of a loss, the insurance settlement will be deposited in the housing project's general operating account unless the settlement exceeds $5,000. If the settlement exceeds $5,000, the funds will be placed in the reserve account for the housing project.

(i) Insurance settlement funds which remain after all repairs, replacements, and other authorized disbursements have been made retain their status as housing project funds.

(ii) If the indebtedness secured by the insured property has been paid in full or the insurance settlement is in payment for loss of property on which the Agency has no claim; a loss draft which includes the Agency as co-payee may be endorsed by the Agency without recourse and delivered to the borrower.

(8) When the Agency is not in the first lien position and the insurance settlement represents satisfactory adjustment of the loss, the Agency will release the settlement funds to the primary mortgagee upon agreement of all parties to the provisions contained in agreements between the Agency and the primary lienholder.

(9) Allowable deductible amounts are as follows:

(i) Hazard/Property Insurance.

(A) $1,000 on any housing project with an insurable value under $200,000; or

(B) One-half of one percent (0.0050) of the insurable value, up to $10,000 on housing projects with insurance values over $200,000.

(ii) Flood Insurance. The Agency allows a maximum deductible of $5,000 per building.

(iii) Windstorm Coverage. When windstorm coverage is excluded from the "All Risk" policy, the deductible must not exceed five percent of the total insured value.

(iv) Earthquake Coverage. In the event that the borrower obtains earthquake coverage, the Agency is to be named as a loss payee. The deductible should be no more than 10 percent of the coverage amount.

(v) Sinkhole Insurance or Mine Subsidence Insurance. The deductible for sinkhole insurance or mine subsidence insurance should be similar to what would be required for earthquake insurance.

(10) Deductible amounts (excluding flood, windstorm, earthquake and sinkhole insurance or mine subsidence insurance) must be accounted for in the replacement reserve account. Borrowers who wish to increase the deductible amount must deposit an additional amount to the reserve account equal to the difference between the Agency's maximum deductible and the requested new deductible. The Borrower will be required to maintain this additional amount so long as the higher deductible is in force.

(g) Liability insurance. The borrower must carry comprehensive general liability insurance with coverage amounts that meet or exceed Agency requirements. This coverage must insure all common areas, commercial space, and public ways in the security premises. Coverage may also include borrower exposure to certain risks such as errors and omissions, environmental damages, or protection against discrimination claims. The insurer's limit of liability per occurrence for personal injury, bodily injury, or property damage under the terms of coverage must be at least $1 million.

(h) Fidelity coverage. Borrowers must provide fidelity coverage on any personnel entrusted with the receipt, custody, and disbursement of any housing monies, securities, or readily salable property other than money or securities. Borrowers must have fidelity coverage in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. In addition, the following conditions apply to fidelity insurance:

(1) Fidelity insurance coverage must be documented on a bond form acceptable to the Agency.

(2) Fidelity coverage policies must declare in the insuring agreements that the insurance company will provide protection to the insured against the loss of money, securities, and property other than money and securities, through any criminal or dishonest act or acts committed by any employee, whether acting alone or in collusion with others, not to exceed the amount of indemnity stated in the declaration of coverage.

(i) The fidelity insurance policy, at a minimum, must include an insuring agreement that covers employee dishonesty.

(ii) Fidelity coverage amounts and deductible:

Fidelity coverage	Deductible level
Under $50,000	$1,000
In the area of $100,000	2,500
In the area of $250,000	5,000
In the area of $500,000	10,000
In the area of $1,000,000	15,000

(3) Blanket crime insurance coverage or fidelity bonds are acceptable types of fidelity coverage.

(4) At a minimum, borrowers must provide an endorsement, listing all of the borrower's Agency financed properties and their locations covered under the policy or bond as evidence of required fidelity insurance. The policy or bond may also include properties or operations other than Agency financed properties on separate endorsement listings.

(5) Individual or organizational borrowers must have fidelity coverage when they have employees with access to the MFH complex assets. Borrowers who use a management agent with exclusive access to housing assets must require the agent to have fidelity coverage on all principals and employees with access to the housing assets. If active management reverts to the borrower, the borrower must obtain fidelity coverage, as a first course of business.

(6) Fidelity coverage is not required under the following circumstances:

(i) The borrower is an individual or a general partnership and the individual or general partner will be responsible for the financial activities of the housing project.

(ii) In the case of a land trust where the beneficiary is responsible for management, the beneficiary will be treated as an individual.

(iii) A limited partnership (or its general partners) unless one or more of its general partners perform financial acts within the scope of the usual duties of an “employee.”

(7) The premium for fidelity coverage of employees and general partners at a housing project is an eligible operating account expense.

(i) The premium of a management agent's fidelity coverage for the agent's principals and employees will be the management agent's business expense (i.e., it is included within the management fee).

(ii) When a housing project employee is covered under the “umbrella” of the management agent's fidelity coverage, the premium may be prorated among the housing projects covered..

(8) Borrowers must review fidelity coverage annually and adjust it as necessary to comply with the requirements of this section.

(i) Taxes. The borrower is responsible for paying all taxes and assessments on a housing project before they become delinquent.

(1) An exception to the above may be made if the borrower has formally contested the amount of the property assessment and escrowed the amount of taxes in question in a manner approved by the Agency.

(2) Failure to pay taxes and assessments when due will be considered a default. If a borrower fails to pay outstanding taxes and assessments, the Agency will pay the outstanding balance and charge the tax or assessment amount, assessed penalties, and any additional incurred costs to the borrower's Agency account.

(3) The Agency will require borrowers who have demonstrated an inability to pay taxes in a timely manner to escrow amounts sufficient to pay taxes.

§§3560.106-3560.149 [Reserved].

§3560.150 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart D--Multi-Family Housing Occupancy

§3560.151 General.

(a) Applicability. This subpart contains borrower and tenant requirements and Agency responsibilities related to occupancy of Agency-financed multi-family housing (MFH) projects. Occupancy eligibility requirements apply to the following:

(1) Family housing projects, including farm labor housing;

(2) Elderly housing projects; and

(3) Congregate housing or group homes for persons with special needs.

(b) Civil rights requirements. All occupancy policies must meet applicable civil rights requirements, as stated in §3560.2.

§3560.152 Tenant eligibility.

(a) General requirements. Except as specified in paragraph (b) of this section, a tenant eligible for occupancy in Agency-financed housing must either:

(1) Be a United States citizen or qualified alien, and

(2) Qualify as a very low-, low-, or moderate-income household; or

(3) Be eligible under the requirements established to qualify for housing benefits provided by sources other than the Agency, such as U.S. Department of Housing and Urban Development (HUD) Section 8 assistance or Low Income Housing Tax Credit (LIHTC), when a tenant receives such housing benefits.

(b) Exception. Households with incomes above the moderate-income level may occupy housing projects with an Agency loan approved prior to 1968 with a loan agreement that does not restrict occupancy by income.

(c) Requirements for elderly housing, elderly units in mixed housing, congregate housing, and group homes. In addition to the requirements of paragraph (a) of this section, the following occupancy requirements apply to elderly housing, elderly units in mixed housing, and congregate housing or group homes:

(1) For elderly housing, elderly units in mixed housing, and congregate housing the following provisions apply:

(i) Households must meet the definition of an elderly household in §3560.11 to be eligible for occupancy in elderly or congregate housing.

(ii) If non-elderly persons are members of a household where the tenant or co-tenant is an elderly person, the non-elderly persons are eligible for occupancy in the tenant's or co-tenant's rental unit.

(iii) Applicants who will agree to participate in the services provided by a congregate housing project may be given occupancy priority.

(2) For group homes, the following provisions apply:

(i) Occupancy may be limited to a specific group of tenants, such as elderly persons or persons with developmental disabilities, or mental impairments, if such an occupancy limitation is contained in the borrower's management plan.

(ii) Tenants must be able to demonstrate a need for the special services provided by the group home.

(iii) Tenants cannot be required to participate in an ongoing training or rehabilitation program.

(iv) Tenants must be selected from the market area prior to considering applicants from other areas.

(d) Ineligible tenant waiver. The Agency may authorize the borrower in writing, upon receiving the borrower's written request with the necessary documentation, to rent vacant units to ineligible persons for temporary periods to protect the financial interest of the Government. Likewise, this provision may extend to a cooperative. This authority will be for the entire project for periods not to exceed one year. Within the period of the lease, the tenant may not be required to move to allow an eligible applicant to obtain occupancy, should one become available. The Agency must make the following determinations:

(1) There are no eligible persons on a waiting list.

(2) The borrower provided documentation that a diligent but unsuccessful effort to rent any vacant units to an eligible tenant household has been made. Such documentation may consist of advertisements in appropriate publications, posting notices in several public places, including places where persons seeking rental housing would likely make contacts, holding open houses, making appropriate contacts with public housing agencies and organizations, Chambers of Commerce, and real estate agencies.

(3) The borrower agrees to continue with aggressive efforts to locate eligible tenants and retain documentation of all marketing.

(4) The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure. The Agency's approval of the waiver would then be for a limited duration.

(5) The lease agreement will not be more than 12 months and at its expiration will convert to a month-to-month lease. The monthly lease will require that the unit be vacated upon 30 days notice when an eligible applicant is available.

(6) Tenants residing in Rural Rental Housing (RRH) units who are ineligible because their adjusted annual income exceeds the maximum for the RRH project will be charged the Rural Housing Service (RHS) approved note rent for the size of unit occupied in a Plan II RRH project. In projects operated under Plan I, ineligible tenants will be charged a rental surcharge of 25 percent of the approved note rent.

(e) Tenant certification and verification. Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of $100 or more per month occurs. Borrowers must recertify for changes of $50 per month, if the tenant requests that such a change be made.

(1) Tenant requirements.

(i) Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.

(ii) Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.

(iii) Tenants must report all changes in household status that may affect their eligibility to borrowers.

(iv) Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in subpart O of this part.

(2) Borrower requirements.

(i) Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.

(ii) Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or tenant contribution.

(iii) Borrowers must submit initial or updated tenant certification forms to the Agency within 10 days of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a first day of the month.

(iv) Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in paragraph (e)(2)(iii) of this section will be charged overage, as specified in §3560.203(c). Unauthorized assistance, if any, will be handled in accordance with subpart O of this part.

(v) Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.

(vi) Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer.

(3) The Agency maintains the right to independently verify tenant eligibility information.

§3560.153 Calculation of household income and assets.

(a) Annual income will be calculated in accordance with 24 CFR 5.609.

(b) Adjusted income will be calculated in accordance with 24 CFR 5.611.

§3560.154 Tenant selection.

(a) Application for occupancy. Borrowers must use tenant application forms that collect sufficient information to properly determine household eligibility and to enable the Agency to monitor compliance with the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and title VI of the Civil Rights Act of 1964 during compliance reviews. At a minimum, borrowers must use application forms that collect the following information:

(1) Name of the applicant and present address;

(2) Number of household members and their birthdates;

(3) Annual income information calculated in accordance with §3560.153(a);

(4) Adjustments to income calculated in accordance with §3560.153(b);

(5) Net assets calculated in accordance with §3560.153(c);

(6) Indication of a need for a unit accessible to individuals with disabilities and any disability adjustments to income;

(7) Certification by the applicant that the unit will serve as the household's primary residence, and a certification that the applicant is a U.S. citizen or a qualified alien as defined in §3560.11;

(8) Signature of the applicant and date;

(9) Race, ethnicity, and sex designation. The following disclosure notice shall be used:

"The information regarding race, ethnicity, and sex designation solicited on this application is requested in order to assure the Federal Government, acting through the Rural Housing Service, that the Federal laws prohibiting discrimination against tenant applications on the basis of race, color, national origin, religion, sex, familial status, age, and disability are complied with. You are not required to furnish this information, but are encouraged to do so. This information will not be used in evaluating your application or to discriminate against you in any way. However, if you choose not to furnish it, the owner is required to note the race, ethnicity, and sex of individual applicants on the basis of visual observation or surname," and

(10) Social security number.

(b) Additional information. Applicants are to be provided a list of any additional information that must be submitted with the application for the application to be considered complete (an application will be considered complete without verification of the applicant information). The list of information will be restricted to the same items for all Agency-assisted properties of a particular type, such as a family or elderly complex.

(c) Application submission. Borrowers must establish when applications may be submitted. Information on the place and times for tenant application submission must be documented in the housing project's management plan and Affirmative Fair Housing Marketing Plan.

(d) Selection of eligible applicants.

(1) Applicants may be determined ineligible for occupancy based on selection criteria other than Agency requirements only if such criteria are contained in the borrower's management plan. Borrower established selection criteria may not contain arbitrary or discriminatory rejection criteria, but may consider an applicant's past rental and credit history and relations with other tenants.

(2) Borrowers with projects receiving low-income housing tax credits (LIHTCs), may leave a housing unit vacant if they are required to rent the available unit to an LIHTC-eligible applicant, and none of the applicants on the waiting list meet the applicable LIHTC eligibility requirements.

(e) Recordkeeping. Borrowers must retain all tenant application forms for at least 3 years. The Agency may require borrowers to submit application information for Agency review.

(f) Waiting lists.

(1) When an applicant has submitted an application form the borrower must place the applicant on the waiting list. All applications, whether complete, eligible, or ineligible, will be placed on the list. The waiting list will document the final disposition of all applications (rejected, withdrawn, or placed in a unit).

(2) The date and time a complete application was submitted will be recorded on the waiting list and will establish priority for selection from the list. If an applicant submits an incomplete application (see paragraph (a) of this section), they must be notified in writing within 10 days of the items that are needed for the application to be considered complete and that priority will not be established until the additional items are received.

(3) The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form available in the servicing office.

(4) Within 10 days of receipt of a complete application, the Borrower must notify the applicant in writing that he has been selected for immediate occupancy, placed on a waiting list, or rejected.

(5) Selections from the completed applications on the waiting list shall be made in the following priority order:

(i) Very low-income applicants;

(ii) Low-income applicants; and

(iii) Moderate-income applicants.

(g) Priorities and preferences for admission.

(1) Eligible applicants that meet the following conditions must be given priority for occupancy over all other tenants regardless of income. Such applicants, however, will be ranked among themselves by income level, giving priority first to very low-income households, then to low-income households, and finally to moderate-income households.

(i) Persons who require the special design features of a unit accessible to individuals with disabilities will have priority only for units with these features.

(ii) In congregate housing facilities, persons who agree to use the services provided by the facility will have priority over other applicants.

(2) Eligible applicants that meet any of the following conditions must be given priority over other applicants in their same income category.

(i) The applicant has a Letter of Priority Entitlement (LOPE) issued in accordance with §3560.660(c).

(ii) The applicant was displaced from Agency-financed housing but was not issued a LOPE.

(iii) The applicant was displaced in a Federally declared disaster area.

(3) Borrowers receiving Section 8 project-based assistance may establish preferences in accordance with U.S. Department of Housing and Urban Development (HUD) regulations. The use of such preferences must be documented in the project's management plan.

(h) Notices of ineligibility or rejection. Borrowers must provide written notification to applicants who are determined to be ineligible or who are rejected for occupancy. Notices of ineligibility or rejection must give specific reasons for the ineligibility determination or rejection and, in accordance with §3560.160, the notice must advise the applicant of "the right to respond to the notice within ten calendar days after receipt" and of "the right to a hearing in accordance with §3560.160 which is available upon request." When an applicant is rejected based on the information from a credit bureau report, the source of the credit bureau report must be revealed to the applicant in accordance with the Fair Credit Reporting Act.

(i) Purging waiting list. Procedures used by borrowers to purge waiting list must be documented in the project's management plan and must be based on the length of the waiting list or the extent of time an applicant will be expected to wait for housing. At a minimum, borrowers must document removal of any names from the waiting list with the time and date of the removal. If an electronic waiting list is used, borrowers must periodically print out electronic waiting lists or preserve backup copies showing how the waiting list appeared before and after the removal of each name.

(j) Criminal activity. Borrowers may deny admission for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.854, 5.855, 5.856, and 5.857.

§3560.155 Assignment of rental units and occupancy policies.

(a) General. Available rental units are assigned in accordance with the requirements of this section and the priorities and preferences outlined in §3560.154.

(b) Rental units accessible to individuals with disabilities. If a rental unit accessible to individuals with disabilities is available and there are no applicants that require the features of the unit, borrowers may rent the unit to a non-disabled tenant subject to the inclusion of a lease provision that requires the tenant to vacate the unit within 30 days of notification from management that an eligible individual with disabilities requires the unit and provided the accessible unit has been marketed as an accessible unit, outreach has been made to organizations representing the disabled, and marketing of the unit as an accessible unit continues after it has been rented to a tenant who is not in need of the special design features.

(c) Transfer of existing tenants within a housing project. When a rental unit becomes available for occupancy and an eligible tenant in the housing project is either over housed or under housed as provided for in paragraph (e) of this section, the borrower must use the available unit for the over housed or under housed tenant, if suitable, prior to selecting an eligible applicant from the waiting list.

(d) Applicant placement. When a specific rental unit type becomes available for occupancy, borrowers must select eligible applicants suitable for the available unit according to the priorities established in §3560.154.

(e) Occupancy policies. Borrowers must establish occupancy policies for each housing project. Households living in a rental unit with more bedrooms than persons in the household will be considered over housed and must be relocated in accordance with paragraph (c) of this section. Households under housed as defined by the project's occupancy standards must be relocated in accordance with paragraph (c) of this section. Borrowers with no one-bedroom units in a housing project may make an exception to this requirement in their occupancy policies. In addition, a borrower's occupancy policies must establish:

(1) Reasonable standards for determining when a tenant household is considered under housed. The standards will describe the maximum number of persons that may occupy units of a given size based on occupancy guidelines provided by the Agency or another governmental source;

(2) The order in which eligible applicants and existing tenants will be housed or re-housed; and

(3) How fair housing requirements will be met, including how reasonable accommodations will be made for applicants and tenants with disabilities.

(f) Agency concurrence. The Agency must concur with a borrower's occupancy rules prior to initial occupancy of the housing project. All modifications to occupancy rules must be posted for tenant comment in accordance with §3560.160 and receive Agency concurrence prior to implementation.

§3560.156 Lease requirements.

(a) Agency approval. Borrowers must use a lease approved by the Agency. The lease must be consistent with Agency requirements and the requirements of all programs participating in the housing project. Prior to submitting the lease to the Agency for approval, borrowers must have their attorney certify that the lease complies with state and local laws, Agency requirements, and the requirements of all programs participating in the housing project. If there are conflicting requirements the borrower shall notify the Agency of the conflict and request guidance. Borrowers must execute their Agency approved lease with each tenant household prior to tenant occupancy of a rental unit.

(b) Lease requirements.

(1) All leases must be in writing.

(2) Initial leases must be for a 1-year period.

(3) If the tenant is not subject to occupancy termination according to §3560.158 and §3560.159, a renewal lease or lease extension must be for a 1-year period.

(4) In areas with a concentration of non-English speaking populations, leases (including the occupancy rules) must be available in both English and the non-English language.

(5) Leases must give the address of the management agent to which tenants may direct complaints.

(6) Leases must include a statement of the terms and conditions for modifying the lease.

(c) Required items and provisions.

(1) Leases for tenants who hold a Letter of Priority Entitlement (LOPE) issued according to §3560.655(d) and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available in the housing project.

(2) Leases must contain a clause permitting escalation in the tenant contribution when there is an Agency-approved change in basic or note rate rents prior to the expiration of the lease. The escalation clause also must specify that the tenant contribution may be changed prior to expiration of the lease if the change is due to changes in tenant status, as documented on the tenant certification form, or the tenant's failure to properly recertify.

(3) Leases must specify that no change in the tenant contribution will occur due to monetary or non-monetary default or when rental assistance or interest credit, is suspended, canceled, or terminated due to the borrower's fault. For information on tenant contributions when a borrower prepays the Agency loan, refer to subpart N of this part.

(4) Leases must contain a requirement that tenants make restitution when unauthorized assistance is received due to applicant or tenant fraud or misrepresentation and a statement advising tenants that submission of false information could result in legal action.

(5) Leases must include a statement that the housing project is financed by the Agency and that the Agency has the right to further verify information provided by the applicant.

(6) Leases must state that the housing project is subject to:

(i) Title VI of the Civil Rights Act of 1964;

(ii) Title VIII of the Fair Housing Act;

(iii) Section 504 of the Rehabilitation Act of 1973; and

(iv) The Age Discrimination Act of 1975.

(7) Leases must establish the tenant's responsibility according to the housing project's occupancy rules to move to the next available appropriately sized rental unit if the household becomes over housed or under housed in the unit they occupy.

(8) Leases must include provisions that establish when a guest will be considered a member of the household and be required to be added to the tenant certification.

(9) Leases must include a provision stating that tenancy continues until the tenant's possessions are removed from the housing either voluntarily or by legal means, subject to state and local law.

(10) Leases must include a requirement that tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in §3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, or whichever is greater, unless the conditions cited in §3560.158(c) exist;

(11) Leases for rental units receiving rental assistance must include clauses that specify that the tenant's monthly tenant contribution and a description of the circumstances under which the tenant's contribution may change.

(12) Leases must include a requirement that tenants notify borrowers when changes occur in their income or assets, their qualifications for adjustments to income, their citizenship status, or the number of persons living in the unit.

(13) A requirement that tenants agree to fulfill the tenant income verification and certification requirements established under §3560.152.

(14) Leases for tenants living in Plan II interest credit rental units must include provisions establishing the net monthly tenant contribution.

(15) Leases, including renewals, must include the following language:

"It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, State, or federal law) while in or on any part of this apartment complex or cooperative is an illegal act. It is further understood that such action is a material lease violation. Such violations (hereafter called a "drug violation") may be evidenced upon the admission to or conviction of the use, possession, manufacture, sale, or distribution of a controlled substance (as defined by local, state, or Federal law) in any local, state, or Federal court.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation to vacate the leased unit permanently, within timeframes set by the landlord, and not thereafter to enter upon the landlord's premises or the lessee's unit without the landlord's prior consent as a condition for continued occupancy by the remaining members of the tenant's household. The landlord may deny consent for entry unless the person agrees to not commit a drug violation in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation, agrees not to commit a drug violation in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program within timeframes specified by the landlord as a condition for continued occupancy in the unit. Should a further drug violation be committed by any non-adult person occupying the unit the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law."

(16) Leases for rental units accessible to individuals with disabilities occupied by those not needing the accessibility features must establish the tenant's responsibility to move to another unit when an appropriate unit becomes available or when the unit is needed by an eligible individual with disabilities. Additionally, the lease clause must require the borrower to provide tenants written notification of the date by which they must move to another unit in the project.

(17) If loan prepayment occurs and the housing project is subject to restrictive use provisions, leases and renewals must be amended to include a clause specifying the tenant protections required under subpart N of this part.

(18) All leases must contain the following information and provisions:

(i) The name of the tenant, any co-tenants, and all members of the household residing in the rental unit;

(ii) The identification of the rental unit;

(iii) The amount and due date of monthly tenant contributions, any late payment penalties, and security deposit amounts;

(iv) The utilities, services, and equipment to be provided for the tenant;

(v) The tenant's utility payment responsibility;

(vi) The certification process for determining tenant occupancy eligibility and contribution;

(vii) The limitations of the tenant's right to use or occupancy of the dwelling;

(viii) The tenant's responsibilities regarding maintenance and consequences if the tenant fails to fulfill these responsibilities;

(ix) The agreement of the borrower to accept the tenant contribution toward rent charges prior to payment of other charges that the tenant owes and a statement that borrowers may seek legal remedy for collecting other charges accrued by the tenant;

(x) The maintenance responsibilities of the borrower in buildings and common areas, according to state and local codes, Agency regulations, and Federal fair housing requirements;

(xi) The responsibility of the borrowers at move-in and move-out to provide the tenant with a written statement of rental unit's condition and provisions for tenant participation in inspection;

(xii) The provision for periodic inspections by the borrower and other circumstances under which the borrower may enter the premises while a tenant is renting;

(xiii) The tenant's responsibility to notify the borrower of an extended absence;

(xiv) A provision that tenants may not assign the lease or sublet the property;

(xv) A provision regarding transfer of the lease if the housing project is sold to an Agency-approved buyer;

(xvi) The procedures that must be followed by the borrower and the tenant in giving notices required under terms of the lease including lease violation notices;

(xvii) The good-cause circumstances under which the borrower may terminate the lease and the length of notice required;

(xviii) The disposition of the lease if the housing project becomes uninhabitable due to fire or other disaster, including rights of the borrower to repair building or terminate the lease;

(xix) The procedures for resolution of tenant grievances consistent with the requirements of §3560.160;

(xx) The terms under which a tenant may, for good cause, terminate their lease, with 30 days notice, prior to lease expiration; and

(xxi) The signature and date clause indicating that the lease has been executed by the borrower and the tenant.

(d) Prohibited provisions. Borrowers are prohibited from including any of the following clauses in the lease:

(1) Clauses prohibiting families with children under 18;

(2) Clauses requiring prior consent by tenant to any lawsuit that borrowers may bring against the tenant in connection with the lease;

(3) Clauses authorizing borrowers to hold any of a tenant's property until the tenant fulfills an obligation;

(4) Clauses in which tenants agree not to hold borrowers liable for anything they may do or fail to do;

(5) Clauses in which tenants agree that borrowers may institute suit without any notice to the tenant that the suit has been filed;

(6) Clauses in which tenants agree that borrowers may evict the tenant or sell their possessions whenever borrowers determine that a breach or default has occurred;

(7) Clauses authorizing the borrower's attorneys to appear in court on behalf of the tenant, and to waive the tenant's right to a trial by jury;

(8) Clauses authorizing the borrower's attorneys to waive the tenant's right to appeal or to file suit; and

(9) Clauses requiring the tenant to agree to pay legal fees and court costs whenever the borrower takes action against the tenant, even if the court finds in favor of the tenant.

(e) Housing projects and units receiving HUD assistance.

(1) In housing projects receiving Section 8 project-based assistance, borrowers may use the HUD model lease. The provisions of the HUD model lease will prevail, unless they conflict with Agency lease requirements in accordance with this section. If there is conflict between HUD requirements and Agency requirements, the provision that will be enforced will be the one that is most favorable to the tenant.

(2) For units occupied by Section 8 certificate and voucher holders, borrowers may use:

(i) A standard HUD-approved lease;

(ii) A HUD-approved lease that includes a number of modifications from the standard HUD-approved lease; or

(iii) An Agency-approved lease may be used if acceptable by HUD or the local housing authority.

(f) State and local requirements. Borrowers must use a lease that is consistent with state and local requirements.

(1) If any lease provision is in violation of state or local law, the lease may be modified to the extent needed to comply with the law, but any changes must be consistent with the provisions established in paragraph (c) of this section.

(2) Leases must include a procedure for handling tenant's abandoned property, as provided by state or local law.

§3560.157 Occupancy rules.

(a) General. The purpose of a borrower's occupancy rules is to outline the basis for the tenant and management relationship. Prior to Agency approval of occupancy rules, borrowers must provide written certification from their attorney that the housing project's occupancy rules are consistent with applicable Federal, state, and local laws, as well as Agency requirements, and the requirements of all programs participating in the housing project. Borrowers must obtain Agency approval of the occupancy rules prior to initial occupancy and obtain Agency approval prior to the implementation date of any subsequent modifications to the rules.

(b) Requirements. The occupancy rules must be in writing and posted for easy tenant access. A copy of these rules must be attached to the tenant's lease upon initial occupancy. At a minimum, the occupancy rules must address:

(1) The tenant's rights and responsibilities under the lease or occupancy agreement;

(2) The rent payment or occupancy charge policies;

(3) The policies regarding periodic inspection of units;

(4) The system for responding to tenant complaints;

(5) The maintenance request and work order procedures;

(6) The housing services and facilities available to tenants or members;

(7) The office locations, hours, and emergency telephone numbers;

(8) The restrictions on storage and prohibitions on non-functional vehicles in the housing project area;

(9) Other requirements related to a subsidy provided to a tenant from non-Agency sources;

(10) When a guest becomes a member of the tenant household; and

(11) The procedures tenants must follow to request reasonable accommodations.

(c) Modification of occupancy rules. The Agency must concur with any modification to the occupancy rules prior to implementation. Proper notice must be given to each tenant at least 30 days in advance of implementation of such rules in accordance with §3560.160.

(d) Federal, state and local requirements. The occupancy rules must be consistent with Federal, state, and local law.

(e) Pets/Assistance Animals. All housing projects should establish reasonable written pet rules. No rules may be promulgated that would prevent occupancy by a household member who requires a service or assistance animal. In elderly housing, borrowers must not prohibit tenants from keeping domestic animals in their rental units as pets.

(f) Tenant organizations. Borrowers must not infringe on the rights of tenants to organize an association of tenants. Borrowers (or a designated management representative) should be available and willing to work with a tenant organization.

(g) Community rooms. Borrowers may not place unreasonable restrictions on tenants that desire to use a community room.

§3560.158 Changes in tenant eligibility.

(a) General requirements. Tenants must continue to meet the requirements of §3560.152 to remain eligible for occupancy.

(b) Tenants no longer eligible. Tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in §3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, whichever is greater, unless the conditions specified in paragraph (c) of this section exist.

(c) Temporary continuation of tenancy. If conditions described in §3560.454(b) or the following conditions exist, borrowers may permit tenants who are no longer eligible for occupancy to continue to reside at the housing project with prior approval of the Agency.

(1) The waiting list for the specific rental unit type has no eligible applicants; or

(2) The required time period for vacating the rental unit would create a hardship on the tenant household.

(d) Surviving and remaining household members.

(1) Members of a household may continue to reside in a housing project after the departure or death of the tenant or co-tenant, provided that:

(i) They are eligible with respect to adjusted income;

(ii) They occupied a rental unit in the housing project at the time of the departure or death of the tenant or co-tenant;

(iii) They execute a tenant certification form establishing their own tenancy; and

(iv) They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

(2) Surviving or remaining members of the household may remain in the housing project, taking into consideration the conditions of paragraph (d)(1) of this section, but must move to a suitably sized rental unit within 30 days of its availability.

(3) After the death of a tenant or co-tenant in elderly housing, the surviving members of the household, regardless of age but taking into consideration the conditions of paragraph (d)(1) of this section, may remain in the rental unit in which they were residing at the time of the tenant's or co-tenant's death, even if the household is over housed according to the housing project's occupancy rules as follows:

(i) Continued occupancy of the rental unit will not be allowed when in either situation of paragraph (d)(1) or (d)(3) of this section, the rental unit has accessibility features for individuals with disabilities, the household no longer has a need for such accessibility features, and the housing project has a tenant application from an individual with a need for the accessibility features;

(ii) If the housing project does not have a tenant application from an individual with a need for the accessibility features, the household may remain in the rental unit with such features until the housing project receives an application from an individual with a need for accessibility features. The household in the unit with accessibility features will be required to move within 30 days of the housing project's receipt of a tenant application requiring accessibility features if another suitably sized unit without accessibility features is available in the project. If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until the first available unit in the project becomes available and then must move within 30 days.

§3560.159 Termination of occupancy.

(a) Tenants in violation of lease. Borrowers, in accordance with lease agreements, may terminate or refuse to renew a tenant's lease only for material non-compliance with the lease provisions, material non-compliance with the occupancy rules, or other good causes. Prior to terminating a lease, the borrower must give the tenant written notice of the violation and give the tenant an opportunity to correct the violation. Subsequently, termination may only occur when the incidences related to the termination are documented and there is documentation that the tenant was given notice prior to the initiation of the termination action that their activities would result in occupancy termination.

(1) Material non-compliance with lease provisions or occupancy rules, for purposes of occupancy termination by a borrower, includes actions such as:

(i) Violations of lease provisions or occupancy rules that are substantial and/or repeated;

(ii) Non-payment or repeated late payment of rent or other financial obligations due under the lease or occupancy rules; or

(iii) Admission to or conviction for use, attempted use, possession, manufacture, selling, or distribution of an illegal controlled substance when such activity occurred on the housing project's premises by the tenant, a member of the tenant's household, a guest of the tenant, or any other person under the tenant's control at the time of the activity.

(2) Good causes, for purposes of occupancy terminations by a borrower, include actions such as:

(i) Actions by the tenant or a member of the tenant's household which disrupt the livability of the housing by threatening the health and safety of other persons or the right of other persons to enjoyment of the premises and related facilities;

(ii) Actions by the tenant or a member of the tenant's household which result in substantial physical damage causing an adverse financial effect on the housing or the property of other persons; or

(iii) Actions prohibited by state and local laws.

(b) Lease expiration or tenant eligibility. A tenant's occupancy in an Agency-financed housing project may not be terminated by a borrower when the lease agreement expires unless the tenant's actions meet the conditions described in paragraph (a) of this section, or the tenant is no longer eligible for occupancy in the housing. Borrowers must handle terminations of occupancy due to a change in tenant eligibility status in accordance with §3560.158. At a minimum, the occupancy termination notice must include the following information:

(1) A specific date by which lease termination will occur;

(2) A statement of the basis for lease termination with specific reference to the provisions of the lease or occupancy rules that, in the borrower's judgment, have been violated by the tenant in a manner constituting material non-compliance or good cause; and

(3) A statement explaining the conditions under which the borrower may initiate judicial action to enforce the lease termination notice.

(c) Other terminations. If occupancy is terminated due to conditions which are beyond the control of the tenant, such as a condition related to required repair or rehabilitation of the building, or a natural disaster, the tenants who are affected by such a circumstance are entitled to benefits under the Uniform Relocation Act and may request a Letter of Priority Entitlement (LOPE) from the Agency. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period.

(d) Criminal activity. Borrowers may terminate tenancy for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.858, 5.859, 5.860, and 5.861.

§3560.160 Tenant grievances.

(a) General.

(1) The requirements established in this section are designed to ensure that there is a fair and equitable process for addressing tenant or prospective tenant concerns and to ensure fair treatment of tenants in the event that an action or inaction by a borrower, including anyone designated to act for a borrower, adversely affects the tenants of a housing project.

(2) Any tenant/member or prospective tenant/member seeking occupancy in or use of Agency facilities who believes he or she is being discriminated against because of age, race, color, religion, sex, familial status, disability, or national origin may file a complaint in person with, or by mail to the U.S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW., Washington DC 20250-9410 or to the Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development (HUD), Washington, DC 20410. Complaints received by Agency

employees must be directed to the National Office Civil Rights Staff through the State Civil Rights Manager/Coordinator.

(b) Applicability.

(1) The requirements of this section apply to a borrower action regarding housing project operations, or the failure to act, that adversely affects tenants or prospective tenants.

(2) This section does not apply to the following situations:

(i) Rent changes authorized by the Agency in accordance with the requirements of §3560.203(a);

(ii) Complaints involving discrimination which must be handled in accordance with §3560.2(b) and paragraph (a)(2) of this section;

(iii) Housing projects where an association of all tenants has been duly formed and the association and the borrower have agreed to an alternative method of settling grievances;

(iv) Changes required by the Agency in occupancy rules or other operational or management practices in which proper notice and opportunity have been given according to law and the provisions of the lease;

(v) Lease violations by the tenant that would result in the termination of tenancy and eviction;

(vi) Disputes between tenants not involving the borrower; and

(vii) Displacement or other adverse actions against tenant as a result of loan prepayment handled according to subpart N of this part.

(c) Borrower responsibilities. Borrowers must permanently post tenant grievance procedures that meet the requirements of this section in a conspicuous place at the housing project. Borrowers also must maintain copies of the tenant grievance procedure at the housing project's management office for inspection by the tenants and the Agency upon request. Each tenant must receive an Agency summary of tenant's rights when a lease agreement is signed. If a housing project is located in an area with a concentration of non-English speaking individuals, the borrower must provide grievance procedures in both English and the non-English language. The notice must include the telephone number and address of USDA's Office of Civil Rights and the appropriate Regional Fair Housing and Enforcement Agency.

(d) Reasons for grievance. Tenants or prospective tenants may file a grievance in writing with the borrower in response to a borrower action, or failure to act, in accordance with the lease or Agency regulations that results in a denial, significant reduction, or termination of benefits or when a tenant or prospective tenant contests a borrower's notice of proposed adverse action as provided in paragraph (e) of this section. Acceptable reasons for filing a grievance may include:

(1) Failure to maintain the premises in such a manner that provides decent, safe, sanitary, and affordable housing in accordance with §3560.103 and applicable state and local laws;

(2) Borrower violation of lease provisions or occupancy rules;

(3) Modification of the lease;

(4) Occupancy rule changes;

(5) Rent changes not authorized by the Agency according to §3560.205; or

(6) Denial of approval for occupancy.

(e) Notice of adverse action. In the case of a proposed action that may have adverse consequences for tenants or prospective tenants such as denial of admission to occupancy and changes in the occupancy rules or lease, the borrower must notify the tenant or prospective tenant in writing. In the case of a Borrower's proposed adverse action including denial of admission to occupancy, the Borrower shall notify the applicant/tenant in writing. The notice must be delivered by certified mail return receipt requested or a hand-delivered letter with a signed and dated acknowledgement of receipt from the applicant/tenant. The notice must give specific reasons for the proposed action. The notice must also advise the tenant or prospective tenant of "the right to respond to the notice within ten calendar days after date of the notice" and of "the right to a hearing in accordance with §3560.160 (f), which is available upon request." The notice must contain the information specified in paragraph (a)(2) of this section. For housing projects in areas with a concentration of non-English speaking individuals, the notice must be in English and the non-English language.

(f) Grievances and responses to notice of adverse action. The following procedures must be followed by tenants, prospective tenants, or borrowers involved in a grievance or a response to an adverse action.

(1) The tenant or prospective tenant must communicate to the borrower in writing any grievance or response to a notice within 10 calendar days after occurrence of the adverse action or receipt of a notice of intent to take an adverse action.

(2) Borrowers must offer to meet with tenants to discuss the grievance within 10 calendar days of receiving the grievance. The Agency encourages borrowers and tenants or prospective tenants to make an effort to reach a mutually satisfactory resolution to the grievance at the meeting.

(3) If the grievance is not resolved during an informal meeting to the tenant or prospective tenant's satisfaction, the borrower must prepare a summary of the problem and submit the summary to the tenant or prospective tenant and the Agency within 10 calendar days The summary should include: The borrower's position; the applicant/tenant's position; and the result of the meeting. The tenant also may submit a summary of the problem to the Agency.

(g) Hearing process. The following procedures apply to a hearing process.

(1) Request for hearing. If the tenant or prospective tenant desires a hearing, a written request for a hearing must be submitted to the borrower within 10 calendar days after the receipt of the summary of any informal meeting.

(2) Selection of hearing officer or hearing panel. In order to properly evaluate grievances and appeals, the borrower and tenant must select a hearing officer or hearing panel. If the borrower and the tenant cannot agree on a hearing officer, then they must each appoint a member to a hearing panel and the members selected must appoint a third member. If within 30 days from the date of the request for a hearing, the tenant and borrower have not agreed upon the selection of a hearing officer or hearing panel, the borrower must notify the Agency by mail of the situation. The Agency will appoint a person to serve as the sole hearing officer. The Agency may not appoint a hearing officer who was earlier considered by either the borrower or the tenant, in the interest of ensuring the integrity of the process.

(3) Standing hearing panel. In lieu of the procedure contained in paragraph (g)(2) of this section for each grievance or appeal presented, a borrower may ask the Agency to approve a standing hearing panel for the housing project.

(4) Examination of records. The borrower must allow the tenant the opportunity, at a reasonable time before a hearing and at the expense of the tenant, to examine or copy all documents, records, and policies of the borrower that the borrower intends to use at a hearing unless otherwise prohibited by law or confidentiality agreements.

(5) Scheduling of hearing. If a standing hearing panel has been approved, a hearing will be scheduled within 15 calendar days after receipt of the tenant's or prospective tenant's request for a hearing. If a hearing officer or hearing panel must be selected, a hearing will be scheduled within 15 calendar days after the selection or appointment of a hearing panel or a hearing officer. All hearings will be held at a time and place mutually convenient to both parties. If the parties cannot agree on a meeting place or time, the hearing officer or hearing panel will designate the place and time.

(6) Escrow deposits. If a grievance involves a rent increase not authorized by the Agency, or a situation where a borrower fails to maintain the property in a decent, safe, and sanitary manner, rental payments may be deposited by the tenant into an escrow account, provided the tenant's rental payments are otherwise current.

(i) The escrow account deposits must continue until the complaint is resolved through informal discussion or by the hearing officer or panel.

(ii) The escrow account must be in a Federally-insured institution or with a bonded independent agent.

(iii) Failure to make timely rent payments into the escrow account will result in a termination of the tenant grievance and appeals procedure and all sums will immediately become due and payable under the lease.

(iv) Receipts of escrow account deposits must be available for examination by the borrower.

(7) Failure to request a hearing. If the tenant or prospective tenant does not request a hearing within the time provided by paragraph (f)(1) of this section, the borrower's disposition of the grievance or appeal will become final.

(h) Requirements governing the hearing. The following requirements will govern the hearing process.

(1) Subject to paragraph (f)(2) of this section, the hearing will proceed before a hearing officer or hearing panel at which evidence may be received without regard to whether that evidence could be used in judicial proceedings.

(2) The hearing must be structured so as to provide basic due process safeguards for both the borrower and the tenants or prospective tenants, which must protect:

(i) The right of both parties to be represented by counsel or other person chosen as their representative;

(ii) The right of the tenant or prospective tenant to a private hearing unless a public hearing is requested;

(iii) The right of the tenant or prospective tenant to present oral or written evidence and arguments in support of their grievance or appeal and to cross-examine and refute the evidence of all witnesses on whose testimony or information the borrower relies; and

(iv) The right of the borrower to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to confront and cross-examine all witnesses in whose testimony or information the tenant or prospective tenant relies.

(3) At the hearing, the tenant or prospective tenant must present evidence that they are entitled to the relief sought, and the borrower must present evidence showing the basis for action or failure to act against that which the grievance or appeal is directed.

(4) The hearing officer or hearing panel must require that the borrower, the tenant or prospective tenant, counsel, and other participants or spectators conduct themselves in an orderly manner. Failure to comply may result in exclusion from the proceedings or in a decision adverse to the interests of the disorderly party and granting or denial of the relief sought, as appropriate.

(5) If either party or their representative fails to appear at a scheduled hearing, the hearing officer or hearing panel may make a determination to postpone the hearing for no more than five days or may make a determination that the absent party has waived their right to a hearing under this subpart. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. Both the tenant or prospective tenant and the borrower must be notified in writing of the determination of the hearing officer or hearing panel.

(i) Decision. Hearing decisions must be issued in accordance with the following requirements.

(1) The hearing officer or hearing panel has the authority to affirm or reverse a borrower's decision.

(2) The hearing officer or hearing panel must prepare a written decision, together with the reasons thereof based solely and exclusively upon the facts presented at the hearing within 10 calendar days after the hearing. The notice must state that the decision is not effective for 10 calendar days to allow time for an Agency review as specified in paragraphs (i)(3) and (i)(4) of this section.

(3) The hearing officer or hearing panel must send a copy of the decision to the tenant, or prospective tenant, borrower, and the Agency.

(4) The decision of the hearing officer or hearing panel shall be binding upon the parties to the hearing unless the parties to the hearing are notified within 10 calendar days by the Agency that the decision is not in compliance with Agency regulations.

(5) Upon receipt of written notification from the hearing officer or hearing panel, the borrower and tenant must take the necessary action, or refrain from any actions, specified in the decision.

§§3560.161-3560.199 [Reserved]

§3560.200 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart E--Rents

§3560.201 General.

This subpart sets forth the requirements for establishing and collecting rents charged to occupants of multi-family housing (MFH) projects financed by the Agency.

§3560.202 Establishing rents and utility allowances.

(a) General. Rents and utility allowances for rental units in Agency-financed housing projects are set by the borrower and must be based on the operating, management and maintenance expenses and other costs related to the housing project including loan payment amounts due to the Agency.

(b) Agency approval. All rents and utility allowances set by borrowers are subject to Agency approval.

(c) Rents. As applicable, borrowers must establish the following rents:

(1) Note rent;

(2) Basic rent;

(3) U.S. Department of Housing and Urban Development (HUD) contract rents; and

(4) Low-income housing tax credit (LIHTC) rents.

(d) Utility allowances. In projects where tenants pay the utilities, borrowers must establish utility allowances for each size and type of rental unit in the housing project based on estimated utility costs. Borrowers must review utility allowances annually, adjust for accuracy, and submit any utility allowance changes to the Agency for approval. If no changes are needed, the borrower must notify the Agency that no changes were made. Documentation to justify utility allowances must be maintained in the housing project files.

(e) Funds contributed to reduce rents. If borrowers use funds contributed from sources other than the Agency (e.g., state or local grants, private contributions) to reduce general operating and management expenses, housing project rents must be reduced to reflect the funding being used to offset housing project expenses. When funds contributed from sources other than the Agency are used for housing project expenses, the borrower must certify to the Agency, in writing, that the funds provided will not need to be repaid with Agency funds. Funds from borrower contributions or rehabilitation loans will not be counted towards reducing rents.

(f) Rents for resident manager, caretaker, or owner-occupied unit.

(1) If approved as a part of a management plan, a borrower may occupy a rental unit in a housing project when they are acting as a management agent or resident manager as specified in §3560.102(e).

(2) If the rental unit being occupied by a borrower or resident manager is designated as a revenue-producing unit, borrowers must calculate the rental charge to the borrower or resident manager in the same manner as tenant contributions.

(3) If the rental unit being occupied by a borrower or resident manager is designated as a non-revenue producing unit, borrowers must treat the cost of providing the unit the same as other non-revenue producing portions of the housing project.

(g) LIHTC. Borrowers who receive LIHTCs may establish rents in accordance with LIHTC requirements. However, borrowers are obligated to ensure that sufficient annual funds are available to cover expenses in the housing project's approved budget, including the required payments on the borrower's Agency loan. Borrowers must not use housing project funds to make up any difference between rents required under Agency program requirements and the maximum allowed rents under the LIHTC program.

§3560.203 Tenant contributions.

(a) Tenant contributions. A tenant's contribution to rent charged for a rental unit in an Agency financed housing project is based on the tenant's income, as calculated on the Agency's tenant certification forms, and the availability of Agency or non-Agency rental subsidies.

(1) Tenant contributions. Borrowers must set tenant contributions to rent at the highest of the following standards but never more than the note rent:

(i) Thirty percent of monthly adjusted income;

(ii) Ten percent of gross monthly income;

(iii) An amount equal to the portion of an assistance payment specifically designated to meet the household's shelter costs if the household is receiving assistance payments from a public agency; or

(iv) The basic rent, unless RHS rental assistance is provided to the household.

(2) Tenant contribution surcharge. Tenants in a Plan I housing project with incomes above the eligibility standards set in §3560.152(a)(1) must pay a 25 percent surcharge in addition to note rent.

(b) Adjustment of tenant contribution. Borrowers must adjust the tenant contribution whenever there is a change in tenant household status or income sufficient to generate a revised tenant certification in accordance with §3560.152(e) or an Agency approved rent or utility allowance change that affects the tenant contribution amount.

(c) Overage. If a tenant's tenant contribution is higher than basic rent, borrowers must remit to the Agency the rent collected in excess of the basic rent and up to the note rent.

§3560.204 Security deposits and membership fees.

(a) General. Borrowers may collect security deposits when it is reasonable and customary for the area in which the housing is located. Borrowers must hold security deposits in a separate bank or bookkeeping account in accordance with §3560.302(c)(3).

(b) Allowable amounts. Borrowers may charge security deposits that are typical for the area in which the housing is located, as long as the security deposit charged a tenant does not exceed that tenant's net contribution for one month's rent or basic rent, whichever is greater.

(1) As noted in §3560.102(b)(1)(viii) and §3560.156(c)(18)(iii), borrowers must specify in the housing project's management plan how the amount to be charged as a security deposit will be established and must specify the amount to be charged to individual tenants in the lease to be signed by the tenant.

(2) Borrowers may charge security deposits to households receiving HUD assistance in accordance with HUD requirements.

(3) Members of a cooperative shall be required to pay a membership fee no greater than one month's occupancy charge.

(4) Additional security deposits for pets may be charged as long as the additional deposit is not greater than basic rent for 1 month. No additional security deposit for assistance animals is allowed where an assistance animal is necessary for the normal functioning of a household member with a disability.

(5) Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

(c) Payment plans. Borrowers must offer, for persons who are eligible for rental assistance or Section 8 assistance, the option of paying the security deposit on an installment payment plan. Should installments not be met, the total charge may become due and payable in full.

(d) Charges for damage or loss. Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

(1) Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

(2) Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts.

(e) State and local security deposit requirements. Borrowers must follow all state and local laws and other requirements governing the handling and disposition of security deposits.

(1) Resolution of any security deposit disputes must be handled in accordance with state and local law.

(2) Any interest earned on security deposits will accrue in accordance with state law.

(f) Unclaimed security deposits. Any funds in the housing project's security deposit account unclaimed by a tenant must be deposited into the housing project's general operating account.

§3560.205 Rent and utility allowance changes.

(a) General. Borrowers must fully document that changes to rents and utility allowances are necessary to cover housing or utility costs allowed under the approved budget for the housing. Any changes must apply to all similar units in the housing project.

(b) Agency approval. Borrowers must submit a fully documented request to the Agency to effect any rent or utility allowance change.

(1) Borrowers must obtain written consent or approval from the Agency as specified in paragraph (e) of this section before implementing any changes in the rents or utility allowances.

(2) If a borrower implements an unauthorized rent or utility allowance charge, the Agency will require the borrower to roll back rents to the last authorized rent charge, and the borrower must reimburse tenants for any unauthorized rents collected.

(c) Timing of request for changes. Borrowers must submit rent and utility allowance change requests in conjunction with the annual budget submission as required under §3560.303(d). The effective dates of any approved changes will coincide with the start of the housing project's fiscal year or the start of the season for seasonally occupied farm labor housing. However, the Agency will accept borrower requests for rent or utility

allowance changes anytime during the year if a change is necessary to preserve the financial integrity of the housing complex and the financial distress is due to circumstances beyond the borrower's control.

(d) Tenant notification. Borrowers must notify tenants and solicit their comments to proposed rent or utility allowance change requests that are submitted to the Agency at the same time that the initial request is made to the Agency.

(1) Tenants will be given 20 calendar days to provide their comments to the Agency.

(2) Borrowers must deliver the proposed rent or utility allowance change request notice to each tenant and post at least one copy of the notice at the housing project site in a visible location frequented by tenants.

(e) Approval. If the Agency approves a rent or utility allowance increase request on which the comments were solicited, the borrower will deliver a notice announcing the rent or utility allowance change to the tenants to be effective 30 calendar days from the date of the notification.

(f) Denial of change request. The Agency may deny a rent or utility allowance increase request in the following circumstances.

(1) The Agency determines that the borrower did not provide sufficient information to justify operating costs.

(2) The borrower is out of compliance with Agency requirements including any corrective action requirements agreed to in a workout agreement developed according to subpart J of this part.

(3) Sufficient funds are being collected under existing rents to meet approved expenses.

(g) Notice of denial. If the rent change will not be approved as requested, the Agency will notify the borrower of the denial in accordance with §3560.303(d).

§3560.206 Conversion to Plan II (Interest Credit).

The Agency encourages any borrower not on Plan II to convert to Plan II to provide more favorable rent costs to very-low, low, and moderate-income households.

§3560.207 Annual adjustment factors for Section 8 units.

(a) General. For rental units receiving project-based Section 8 assistance, the Agency will review rents annually without regard to HUD's automatic annual adjustment.

(b) Establishing rents in housing with HUD rent assistance. Borrowers will set note and basic rents for housing receiving HUD project based Section 8 assistance, as specified in §3560.202(c)(3).

(1) Borrowers must notify the Agency of any HUD rent changes.

(2) If allowed by the interest credit agreement, the borrower will remit the amount collected in excess of the basic rent up to the note rent to the Agency as overage.

(3) When HUD contract rents exceed note rents, borrowers must deposit HUD funds equal to the difference between the Agency approved note rent and the HUD approved rent into the reserve account for the housing project.

(c) Excess HUD rents. When permitted by the Agency interest credit agreement, the Agency may reduce or cancel the interest credit on the housing, if excess HUD rents deposited in the reserve account result in the reserve account being funded beyond the fully funded level approved by the Agency.

§3560.208 Rents during eviction or failure to recertify.

(a) Rents during eviction. If a tenant is appealing an eviction and the borrower refuses to accept rent payment during the appeal of the eviction, the tenant must escrow required rent payments to safeguard their occupancy, unless State or local laws specify otherwise.

(b) Rents when tenants fail to recertify. If a borrower can document that a tenant received a notice specifying a tenant recertification date and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, shall give the tenant and the Agency written notification that:

(1) Termination proceedings are being initiated, in accordance with §3560.159; and

(2) The tenant will be charged note rent until the tenant's lease is terminated.

(c) Unauthorized assistance due to tenant recertification failure. Any unauthorized assistance received because of the tenant's failure to be recertified will be collected in accordance with the provisions of subpart O of this part.

(d) Rents when borrowers fail to recertify tenants. If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants shall continue to make net tenant contributions to rent based on their most recent tenant certification and the borrower must remit to the Agency full overage as if the tenant was paying the note rent until the tenant is recertified.

(e) Unauthorized assistance due to borrower recertification failure. Any unauthorized assistance received as a result of the borrower's failure to recertify a tenant will be collected from the borrower in accordance with the provisions of subpart O of this part and may not be paid from housing project funds or funds collected from the tenant.

§3560.209 Rent collection.

(a) General. Borrowers must collect rents on a monthly basis and maintain a system for collecting and tracking rents.

(b) Fees for late rent payments. Borrowers may adopt a late fee schedule for overdue rental payments. Late fee schedules must be submitted to the Agency for approval as part of the housing project's management plan, be in accordance with State and local law, and consistent with the following requirements:

(1) A grace period of 10 days from the rental payment due date must be allowed for all tenants.

(2) The late fee must not exceed the higher of $10 or an amount equal to 5 percent of the tenant's gross tenant contribution.

(3) Tenants receiving housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

(c) Improperly advanced rents. Improperly advanced interest credit or rental assistance is considered unauthorized assistance and is subject to recapture in accordance with subpart O of this part.

§3560.210 Special note rents (SNRs).

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge an SNR, which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent. The requirements for requesting and receiving an SNR are established under §3560.454.

§§3560.211-3560.249 [Reserved]

§3560.250 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart F--Rental Subsidies

§3560.251 General.

This subpart contains policies for borrower administration and tenant use of rental subsidies in Agency financed multi-family housing (MFH) projects.

§3560.252 Authorized rental subsidies.

(a) General. The purpose of rental subsidies is to reduce amounts paid by tenants for rent. Rental subsidies equal the difference between the approved shelter costs and tenant contributions as calculated in accordance with §3560.203(a)(1).

(b) Forms of rental subsidies. Rental subsidies may be in the form of:

(1) Agency rental assistance;

(2) HUD section 8 assistance, including project-based and vouchers;

(3) Private rental subsidies; or

(4) State or local government rental subsidies.

(c) Multiple rent subsidies.

(1) Multiple types of rent subsidies may be used in the same MFH project.

(2) Tenants with subsidies from sources other than the Agency may be eligible for Agency rental assistance if the following conditions are met.

(i) The tenant qualifies for Agency rental assistance.

(ii) The rental subsidy the tenant is receiving is not a HUD voucher.

(iii) The rental subsidy being received by the tenant is less than the full amount of Agency rental assistance for which the tenant would qualify. In such cases, the Agency may provide the difference between the subsidy received by the tenant and the amount of Agency rental assistance for which the tenant qualifies.

(d) Agency rental assistance (RA). Agency RA is obligated to MFH projects on a rental unit basis. The obligation is composed of a number of rental units and associated dollar amounts of RA specified in a RA agreement with a borrower. The following types of Agency RA may be obligated to a housing project.

(1) Renewal units. RA may be assigned to a housing project to replace existing rental unit obligations because funds associated with the units have been fully disbursed.

(2) New construction units. RA may be provided in conjunction with initial Agency loans for construction or substantial rehabilitation of MFH projects.

(3) Servicing units. Additional RA may be provided to operational MFH projects as a part of the Agency's general loan servicing or preservation activities.

§3560.253 [Reserved]

§3560.254 Eligibility for rental assistance.

(a) Eligible housing. Housing projects eligible for Agency RA include the following types of projects.

(1) Housing projects that operate under an Interest Credit Plan II RA agreement.

(2) Housing projects financed with an Agency off-farm labor housing loan or grant. On-farm labor housing is not eligible for rental assistance.

(3) Housing projects financed with a direct or insured Rural Rental Housing loan approved prior to August 1, 1968, and operated under an interest credit agreement that identifies the housing project as a Plan RA project.

(4) Housing projects financed from Agency and other sources if the conditions of §3560.66 are met.

(b) Eligible units. Borrowers may not request RA for rental units that the Agency determines are not habitable in accordance with §3560.103.

(c) Eligible households. Households eligible for rental assistance are those:

(1) With very low-or low-incomes who are eligible to live in MFH;

(2) Whose net tenant contribution to rent determined in accordance with §3560.203(a)(2) is less than the basic rent for the unit;

(3) Whose head of the household is a U.S. citizen or a legal alien as defined in §3560.11;

(4) Who meet the occupancy rules established by the borrower in accordance with §3560.155(e); and

(5) Who have a signed, unexpired tenant certification form on file with the borrower.

§3560.255 Requesting rental assistance.

(a) Submitting requests. Borrowers seeking an allocation of rental assistance for MFH must request the rental assistance from the Agency as follows.

(1) Renewal rental assistance. To the extent sufficient funds are available, the Agency will automatically renew expiring rental assistance agreements at the existing number of units.

(2) New construction units. Loan applicants proposing to use Agency rental assistance must include their request for rental assistance in their loan proposal in accordance with §3560.56.

(3) Servicing units. Borrowers requesting rental assistance must have tenants or eligible tenant applicants on a waiting list who are RA eligible.

(b) Denial of requests.

(1) If a rental assistance request is denied due to the loan applicant's or borrower's ineligibility, the Agency will send the loan applicant or borrower written notification of the decision with an explanation of the denial.

(2) If a rental assistance request to renew expiring rental assistance agreements is denied because funding is not available, the Agency will notify the borrower and the borrower must notify the tenants of rent increases in accordance with their lease and state and local law. Tenants losing rental assistance due to a lack of Agency funding may quit the lease and vacate the housing without penalty in accordance with the terms of their lease.

(3) Loan applicants or borrowers determined to be eligible for RA as a result of an appeal or funding review will receive RA, if RA funding is available, beginning with the month following the date of the appeal or funding review decision or beginning in the first month that RA funding becomes available.

§3560.256 Rental assistance payments.

(a) Borrower submission requirements. The borrower must submit monthly requests for RA payments to the Agency based on occupancy as of the first day of the month previous to the month in which the request is being made.

(b) Basis of RA requests. Borrower requests for RA payments must be based on the difference between the basic rent plus utility allowances for each rental unit eligible for RA and the net tenant contribution of the tenant.

(c) Payments to borrower. Prior to making RA payments to a borrower, the Agency will deduct from the approved RA payment amount any unpaid loan payments, late fees, and other amounts which the borrower owes to the Agency.

(d) Utility payments to tenants. The borrower must pay tenants the difference between the utility allowance and the tenant's net contribution to rent when a tenant receiving RA is billed directly for utilities and the utility allowance exceeds the net tenant contribution to rent. Such utility payments to tenants must be made on a monthly basis.

(e) Administrative errors. Borrowers are responsible for correcting borrower errors made in regard to RA requests for payments. In accordance with subpart O of this part, borrowers will be required to repay the Agency for any unauthorized RA received or any unauthorized use of RA except in certain cases of tenant error or fraud.

§3560.257 Assigning rental assistance.

(a) Priorities for rental assistance.

(1) Borrowers must use the following priorities when assigning available rental assistance.

(i) First priority is to eligible very low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(ii) Second priority, if the housing project has vacant rental units, is to eligible very low-income applicants on the waiting list.

(iii) Third priority is to eligible low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(iv) Fourth priority, if the housing project has vacant rental units, is to eligible low-income applicants on the waiting list.

(v) Fifth priority is to households which are residing in a rental unit for which they do not qualify on the basis of an occupancy waiver or other special approval situations.

(2) In order to provide rental assistance to the third, fourth, and fifth priority categories, a borrower must fully document either that there are no very low-income households on the housing project's waiting list or that occupancy by low-income households is limited as follows:

(i) For housing occupied on or after November 30, 1983, no more than 5 percent of the units in the housing are occupied by low-income households; or

(ii) For housing occupied before November 30, 1983, no more than 25 percent of the units in the housing are occupied by low-income households.

(b) Continued eligibility. Tenants receiving rental assistance may continue to do so as long as they remain eligible for occupancy and for rental assistance under §3560.254(c), and as long as rental assistance units are available.

(c) Assignment of rental assistance. Except as provided in §3560.454(c) and using the priorities given in paragraph (a) of this section, borrowers must assign available rental assistance units as soon as rental assistance units become available.

(1) When a rental assistance unit is assigned to an eligible existing tenant on a day other than the first day of a month, the Agency will not provide the borrower rental assistance for the newly assigned existing tenant and the tenant will not pay reduced rental charges until the first of the month following the assignment of the rental assistance.

(2) When an eligible applicant moves into a rental assistance unit on a day other than the first day of a month, they will pay a prorated rent based on the number of days they occupy the rental assistance unit and the amount of rental assistance they will be receiving.

(d) Incorrectly assigned rental assistance. Incorrectly assigned rental assistance is viewed as unauthorized assistance and handled in accordance with subpart O of this part.

§3560.258 Terms of agreement.

(a) Term of agreement. Rental assistance agreements will be consistent with available funding. Rental assistance agreements expire when the funds obligated for rental assistance units are fully disbursed in accordance with the conditions of the agreement.

(b) Replacing expiring obligations. To the extent funds are available for replacement units, the Agency will renew rental assistance agreements.

§3560.259 Transferring rental assistance.

(a) Agency authority. The Agency may transfer rental assistance in the following instances:

(1) To accompany the transfer of a housing project to a different borrower;

(2) After a voluntary conveyance or a foreclosure sale;

(3) After a liquidation or prepayment;

(4) To the extent permitted by law, when any rental assistance units have not been used for a 6-month period; or

(5) When the loan cannot be closed.

(b) Agency review before transferring rental assistance. The Agency must perform a review to determine if all eligible tenants in the project are receiving rental assistance before the Agency transfers it to another project.

(c) Transferring rental assistance for displaced tenants. The Agency may transfer rental assistance from one housing project to another eligible housing project for a tenant who is moving due to displacement as a result of prepayment, liquidation, or a natural disaster. The tenant must begin using the rental assistance within 4 months of the transfer or the RA will become available for use by the next rental assistance eligible tenant in the housing project.

§3560.260 Rental subsidies from non-Agency sources.

(a) General. The Agency may authorize the use of rental subsidies from sources other than the Agency in Agency financed housing projects. The Agency will make no commitment to providing Agency rental assistance at the expiration of the rental subsidies from other sources.

(b) HUD vouchers. For tenants with HUD vouchers, the borrower must set the rental unit rent at the basic rent or the rent standard set by the public housing authority, whichever is less. The public housing authority distributing the HUD vouchers may set the utility allowance.

(c) Loan proposals using non-Agency rental subsidy. Loan applicants or borrowers proposing to use rental subsidy from sources other than the Agency must provide:

(1) Documentation demonstrating that a market exists for households eligible for the subsidy and the households are at income levels that would benefit from the amount of rental subsidy that will be provided;

(2) A plan describing actions to be taken when the rental subsidy expires to minimize the impact on tenants losing the rental assistance and to avoid displacement; and

(3) A copy of the project-based rental assistance agreement to be signed by the borrower and the provider of the rental assistance.

(d) Rental subsidy agreement. The borrower and the provider of rental subsidies from sources other than the Agency must execute a rental subsidy agreement and submit a copy of the agreement to the Agency. At a minimum, the rental subsidy agreement between the borrower and the source of the rental subsidy must include the following provisions:

(1) A description of how the subsidy will be paid. The rental subsidy payments may be paid directly to the tenants, to the borrower on behalf of the tenants, or deposited to a separate account established for the subsidy. The tenants must be advised of the amount and source of the subsidy through the lease or a supplement to the lease.

(2) The life of a project-based rental subsidy agreement with a non-Agency source must be similar to existing or current Agency rental assistance funding levels and sufficient funds must be set aside to assure availability of the rental subsidy for this term. The method of supplying the funds must be clearly established.

§3560.261 Improperly advanced rental assistance.

Improperly advanced RHS rental assistance resulting from tenant or borrower error or fraud constitutes unauthorized assistance and the provisions of subpart O of this part apply.

§§3560.262-3560.299 [Reserved]

§3560.300 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart G--Financial Management

§3560.301 General.

This subpart contains requirements for the financial management of Agency-financed multi-family housing (MFH) projects, including accounts, budgets, reports, and engagements. Financial management systems and procedures must cover all housing operations and provide adequate documentation to ensure that program objectives are met.

§3560.302 Accounting, bookkeeping, budgeting, and financial management systems.

(a) General. Borrowers must establish the accounting, bookkeeping, budgeting and financial management procedures necessary to conduct housing project operations in a financially safe and sound manner. Borrowers must maintain records in a manner suitable for an engagement and must be able to report accurate operational results to the Agency from these accounts and records.

(b) Acceptable methods of accounting.

(1) Borrowers may use a cash, accrual, or modified accrual method of accounting, bookkeeping, and budget preparations as long as the method is consistent with the statements required by the engagement in accordance with the standards identified in §3560.308.

(2) Borrowers must describe their accounting, bookkeeping, budget preparation, and financial reporting procedures, including Agency-approved engagements, in their management plan.

(3) Borrowers must notify the Agency of any changes in their accounting, bookkeeping, budget preparation, and financial management reporting systems through a revision of their management plan.

(c) Account requirements.

(1) As used in this paragraph, the term account is used interchangeably to mean a bookkeeping account (ledger) or a bank account.

(2) At a minimum, borrowers must maintain the accounts required by their loan agreement or resolution.

(3) The following list identifies the financial accounts that are required for each housing project. Additional accounts may be required by third-party lenders. Accounts are to be funded in the following priority order, except that paragraphs (c)(3)(iv), (v), and (vi) of this section are funded directly by tenant security deposits or patron capital receipts respectively:

(i) General operating account;

(ii) Real estate tax and insurance account (if not part of the general operating account);

(iii) Reserve account;

(iv) Tenant security deposit account;

(v) Membership fee account for cooperative housing; and

(vi) For cooperative housing only, a patron capital account.

(4) Amounts escrowed for taxes and insurance may be kept in the general operating account as long as the accounting system reflects the amount escrowed.

(5) Regardless of the number or types of accounts established, the borrower must meet the following requirements:

(i) All housing project funds must be held only in financial institution accounts insured by an agency of the Federal Government, backed by collateral provided by the bank, or held in securities meeting the conditions in this subpart.

(ii) Funds maintained in an institution may not exceed the limit established for Federal deposit insurance. If funds exceed the amount covered by Federal deposit insurance, borrowers must obtain a collateral pledge from the institution to cover all funds or must move funds to an institution that will insure the funds.

(iii) All funds and proceeds in any account must be used only for authorized purposes as described in Agency's regulations, loan or grant documents. Use of funds for non-program purposes constitutes non-monetary default as described in §3560.452(c).

(iv) All funds received and held in any account, except the tenant security deposit, membership fee, and patron capital accounts, must be held in trust by the borrower for the loan obligation until used and serve as security for the Agency loan or grant.

(v) Borrowers must be able to account for housing project funds with accounting methods or practices that maintain the proprietary identity of the funds for each project. A borrower may operate one account for multiple projects as long as the funds for each project themselves are accounted for separately.

(vi) Each borrower must have access to at least one demand deposit or checking account.

(vii) Housing project funds may not be pledged as collateral for debts without Agency approval. If such a need arises for an eligible program purpose, the borrower must obtain prior Agency approval.

(6) Tenant security deposit accounts or membership fee accounts and patron capital accounts must be maintained in a separate account in trust for the tenants or members and handled in a manner consistent with state and local laws.

(d) Documentation of separate accountability. Housing project funds may be combined in one or more bank accounts for two or more housing projects as long as the borrower's accounting system segregates and tracks funds for each project separately.

(1) When borrowers request Agency approval of an accounting system that combines funds from two or more housing projects, they must demonstrate to the Agency that the accounting systems are structured to segregate and maintain separate accountability for each housing project. Such demonstration must include a statement issued by a Certified Public Accountant (CPA) stating that the accounting system is structured to meet this principle of separate accountability.

(2) The accounting system and management plan must document the method for prorating revenue and expenses that are not clearly identifiable as being associated with a particular housing project.

(3) Funds for housing projects managed by the same management company must not be co-mingled.

(e) Records.

(1) Borrowers must retain all housing project financial records, books, and supporting material for at least three years after the issuance of the engagement and financial reports. Upon request, these materials will immediately be made available to the Agency, its representatives, the USDA Office of the Inspector General (OIG), or the General Accountability Office (GAO).

(2) Borrower accounts and records will be kept or made available in a location with reasonable access for inspection, review, and copying by the Agency, other authorized representatives of the USDA, OIG, or GAO.

(3) Automated records may be used if they meet the conditions of paragraph (f) of this section.

(f) Forms generated by automated systems.

(1) The forms and formats approved for use by borrowers may be prepared on automated systems when they meet the requirements of this paragraph.

(2) Forms may be automated if they meet the following requirements:

(i) The identical wording and nomenclature of an official form must be included in the automated version of the form, including the Office of Management and Budget (OMB) approval number.

(ii) The logic or mathematical calculation of an official form must be the same in an automated version of the form.

(iii) The name or logo of the source of the automated form must be visible on each output of the automated form.

(iv) Output size must be 8\1/2\ x 11 inches.

(v) Nominal spacing adjustment and colored paper are allowed.

(g) Farm Labor Housing. Borrowers with on-farm labor housing units will be considered in compliance with this section by virtue of completing the record keeping and reporting requirements outlined in subpart M of this part.

§3560.303 Housing project budgets.

(a) General requirements.

(1) Using an Agency-approved format, borrowers must submit to the Agency for approval a proposed annual housing project budget prior to the start of the housing project's fiscal year. The capital budget section of the annual project budget must include anticipated expenditures on the project's long-term capital needs as specified in §3560.103(c).

(2) Budget projections regarding income, expenses, vacancies, and contingencies must be realistic given the housing project's history, current circumstances, and market conditions.

(3) Borrowers must document that the operating expenses included in the budget accurately reflect reasonable and necessary costs to operate the housing project in a manner consistent with the objectives of the loan and in accordance with the applicable Agency requirements.

(4) Borrower must submit supporting documentation to justify housing project utility allowances.

(5) Upon Agency request, borrowers must submit any additional documentation necessary to establish that applicable Agency requirements have been met.

(b) Allowable and unallowable project expenses. Expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes.

(1) Allowable expenses. Allowable expenses include those expenses that are directly attributable to housing project operations and are necessary to carry out successful operations.

(i) Housing project expenses must not duplicate expenses included in the management fee as defined in §3560.102(i).

(ii) Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This includes managers, maintenance staff, and temporary help including their:

(A) Gross salary;

(B) Employer FICA contribution;

(C) Federal unemployment tax;

(D) State unemployment tax;

(E) Workers compensation insurance;

(F) Health insurance premiums;

(G) Cost of fidelity or comparable insurance;

(H) Leasing, performance incentive or annual bonuses;

(I) Direct costs of travel to off-site locations by on-site staff for property business or training; and/or

(J) Retirement benefits.

(iii) Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and the preparation of all legal documents.

(iv) All outside account and auditing fees, if required by the Agency, directly related to the preparation of the annual audit, partnership tax returns and 401-K's, as well as other outside reports and year-end reports to the Agency, or other governmental agency.

(v) All repair and maintenance costs for the project including:

(A) Maintenance staffing costs and related expenses.

(B) Maintenance supplies.

(C) Contract repairs to the projects (e.g., heating and air conditioning, painting, roofing).

(D) Make ready expenses including painting and repairs, flooring replacement and appliance replacement as well as drapery or mini-blind replacement. (Turnover maintenance).

(E) Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.

(F) Snow removal.

(G) Elevator repairs and maintenance contracts.

(H) Section 504 and other Fair Housing compliance modifications and maintenance.

(I) Landscaping maintenance, replacements, and seasonal plantings.

(J) Pest control services.

(K) Other related maintenance expenses.

(vi) All operational costs related to the project including:

(A) The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

(B) The cost of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.

(C) All bank charges related to the property including purchases of supplies (e.g., checks, deposit slips, returned check fees, service fees).

(D) Costs of site-based telephone including initial installation, basic services, directory listings, and long-distances charges.

(E) All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.

(F) Postage and delivery costs from the site including expenses to the Agency or other governmental agencies, tenants, verifying third parties, central management offices, etc.

(G) Partnership or corporate business expenses including state taxes and other mandated state or local fees as well as other relevant expenses required for operation of the property by a third-party governmental unit. Costs of continuation financing statements and site license and permit costs.

(H) Expenses related to site utilities including actual costs and surcharges as well as deposits and expense of utility bonds in lieu of bonds.

(I) Site office furniture and equipment including site based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by the Agency).

(J) Real estate taxes (personal tangible property and real property taxes) and expenses related to controlling or reducing taxes.

(K) All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.

(L) Costs of collecting rents on-site including bookkeeping supplies and recordkeeping items.

(M) Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies and other associated expenses.

(N) Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.

(O) Tax Credit Compliance Monitoring Fees imposed by HFAs.

(P) All insurance deductibles as well as adjuster expenses.

(Q) Professional service contracts (audits and compilations, tax returns, energy audits, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.)

(R) On-site training pre-approved by the Agency provided by outside training vendors.

(S) Site manager salary for additional hours associated with congregate housing.

(vii) With prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities. Such expenses may include:

(A) Errors and omissions insurance policy for the Board of Directors.

(B) Board of Director review and approval of proposed Agency's annual operating budgets, including proposed repair and replacement outlays and accruals.

(C) Board of Director review and approval of capital expenditures, financial statements, and consideration of any management comments noted.

(D) Long-term asset management reviews.

(2) Unallowable expenses. Housing project funds may not be used for any of the following:

(i) Equity skimming as defined in 42 U.S.C. 543 (a).

(ii) Purposes unrelated to the housing project.

(iii) Reimbursement of inaccurate or false claims.

(iv) Settlement agreements, court ordered decrees, legal fees, or other costs that result from the filing of civil rights complaints or legal action alleging the borrower, or a representative of the borrower, has committed a civil rights violation.

(v) Fines, penalties, and legal fees where the borrower or a borrower's representative has been found guilty of violating laws, including, but not limited to, civil rights, and building codes.

(vi) Association dues to be paid by the project should be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.

(vii) Pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(viii) Billing for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff.

(ix) Billing for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(c) Priorities. The priority order of planned and actual budget expenditures will be:

(1) Senior position lienholder, if any;

(2) Operating and maintenance expenses, including taxes and insurance;

(3) Agency debt payments;

(4) Reserve account requirements;

(5) Other authorized expenditures; and

(6) Return on owner investment.

(d) Agency review and approval.

(1) The Agency will only approve housing project budgets that meet the requirements of paragraphs (a), (b) and (c) of this section.

(2) If no rent change is requested, borrowers must submit budget documents for Agency approval 60 calendar days prior to the start of the housing project's fiscal year. The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section. The borrower will have 10 days to submit the additional material.

(3) If a rent change is requested, the borrower must submit budget documents to the Agency and notify tenants of the requested rent change at least 90 calendar days prior to the start of the housing project's fiscal year.

(i) The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section, or if the rent and utility allowance request has been denied in accordance with §3560.205(f). The borrower will have 10 days to submit the additional material to address any issues raised by the Agency.

(ii) The rent change is not approved until the Agency issues a written approval. If there is no response from the Agency within the 30-day period, the rent change is considered automatic. The following budgets are not eligible for automatic approval:

(A) Budgets with rent increases above $25 per unit; and

(B) Budgets that are submitted late or that miss other deadlines set by the Agency.

(4) If the Agency denies the budget approval, the Agency will notify the borrower in writing.

(5) If budget approval is denied, the borrower shall continue to operate the housing project on the basis of the most recently approved budget.

§3560.304 Initial operating capital.

(a) Purpose. To provide a source of capital for start-up costs, such as the purchase of equipment, and paying operating, maintenance, and debt service expenses. Borrowers are required to make an initial operating capital contribution to the general operating account as described in §3560.64.

(b) Authorized uses of initial operating capital. Initial operating capital may be used only to pay for approved budgeted expenses.

(c) Withdrawal of initial operating capital. Initial operating capital funds may be withdrawn by a borrower if:

(1) The initial operating capital was provided from the borrower's own funds;

(2) The borrower requests the withdrawal after the second year of housing project operations and prior to the 7th year of operations;

(3) The housing project has had a 90 percent occupancy rate for a period of 12 months prior to the withdrawal request;

(4) The withdrawal will not affect the financial viability of the housing project;

(5) Contributions to the reserve account are at authorized levels;

(6) The withdrawal request will not result in rent increases; and

(7) There are no outstanding deficiencies in management's physical maintenance of the housing project.

§3560.305 Return on investment.

(a) Borrower's return on investment. Borrowers may receive a return on their investment (ROI) in accordance with the terms of their loan agreement and the following:

(1) If there is a positive net cash flow in housing project operations, the ROI may be taken by the borrower after the housing project's fiscal year, provided that the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that an ROI should not have been taken, borrowers will be required to return any unauthorized ROI.

(2) If there is negative cash flow in housing project operations, the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the housing project's annual financial reports and determines:

(i) Surplus cash exists in either the general operating account as defined in §3560.306(d)(1) or the reserve account, if the balance is greater than the required deposits minus authorized withdrawals.

(ii) The housing project has sufficient funds to address identified capital or operational needs.

(b) Unpaid return on investment. An earned, but unpaid ROI for the previous year only may be requested by the borrower and authorized by the Agency under the provisions of §3560.305(a)(2) provided the current year's ROI has been paid first and a rent increase is not required to generate funds to pay the unpaid ROI.

§3560.306 Reserve account.

(a) Purpose. To meet the major capital expense needs of a housing project, borrowers must establish and maintain a reserve account.

(b) Financial management of the reserve account. Borrower management of the reserve account is subject to the requirements of 7 CFR part 1902, subpart A regarding supervised bank accounts.

(c) Funding of the reserve account. Borrowers must make payments to the reserve account in the amount established in loan documents, beginning with the first loan payment or a date specified in loan documents.

(d) Transfer of surplus general operating account funds.

(1) The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, include the amount that should be escrowed by year end and subtract such tax and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

(2) If a housing project's general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year. At the end of the borrower's fiscal year, if the borrower is required to transfer surplus funds from the general operating account to the reserve account, the transfer does not change the future required contributions to the reserve account.

(e) Account requirements. Borrowers must establish and maintain the reserve account according to §3560.65, §3560.302(c)(5), and the following requirements:

(1) Reserve accounts must be deposited in interest-bearing accounts or securities; and

(2) Reserve accounts must be supervised accounts that require the Agency to countersign on all withdrawals; except, this requirement is not applicable when loan funds guaranteed by the Section 538 GRRH program are used for the construction and/or rehabilitation of a direct MFH loan project. Direct MFH loan borrowers, who are exempted from the supervised account and countersigned requirement, as described above, must follow Section 538 GRRH program regulatory requirements pertaining to reserve accounts. In all cases, Section 538 lenders must get prior written approval from the Agency before reserve account funds involving a direct MFH loan project can be disbursed to the borrower. (Revised 04-27-16, PN 485.)

(f) Funds invested in securities. In addition to the requirements specified in paragraph (e) of this section, the following requirements apply when reserve funds are invested in securities:

(1) The reserve account must be held either at a Federally insured domestic institution such as a bank, savings and loan association, credit union, or at a domestic institution authorized to sell securities.

(2) The borrower must record the price actually paid for the securities. When designated as a reserve deposit, the price paid must equal the required contribution to reserves.

(3) Borrowers must be knowledgeable about industry practices and consider the impact of typical fees and charges for purchases and sales and maintenance of an account when making investment decisions. Such fees may be paid for out of reserves, only with the consent of the Agency. Housing project funds may not be used to pay for a financial advisor.

(g) Use of the reserve account.

(1) Borrowers must request Agency approval of reserve account withdrawals prior to the withdrawal. Borrowers must inform the Agency of planned uses of reserve accounts in their annual capital budget if known at budget planning time. Any item on the approved capital budget does not require additional pre-approval by the Agency.

(2) The Agency will indicate any conditions governing withdrawals from a reserve account at the time it approves the withdrawal.

(3) In emergency situations, the Agency may specify special procedures to provide an expedited approval process for the use of the reserve account.

(4) The Agency may approve the use of reserve funds for operating costs when circumstances that are determined by the Agency to be beyond the borrower's control have resulted in a shortfall in the housing project's general operating account.

(5) Funds from the replacement reserve account cannot be used to pay any fees associated with the Section 538 GRRH loan guarantee, as determined by the Agency.

(h) Allowable uses. Allowable uses of reserve funds include the following:

(1) Major capital improvements and replacements.

(2) Housing project operating expenses provided the requirement of paragraph (g)(4) of this section has been met, including:

(i) Payments due on the loan, or

(ii) Payment of a return on investment at the end of the borrower's fiscal year if such payment comes from surplus operating funds in the reserve account.

(3) With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year.

(4) For other purposes, which in the judgment of the Agency will promote the loan purposes, strengthen the security or facilitate, improve, or maintain the housing and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security.

(i) Records. Borrowers must maintain records documenting all expenses that were paid by withdrawals from the reserve account.

(j) Changes to reserve requirements.

(1) As projects age, the required reserve account level may be adjusted to meet anticipated “life-cycle” needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

(2) The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

(k) Excess reserves. Amounts in the reserve account which exceed the total required by the loan or grant agreement must be used, at the direction of the Agency, for any of the following:

(1) Pay for expenses specified in a long-term capital plan;

(2) Make payments and reamortize the Agency loan;

(3) Reduce rents by a transfer to the general operating account;

(4) Fund preservation incentives authorized in subpart N of this part; or

(5) Cover other expenditures determined to be related to the purpose of the housing project and in the best interest of the Federal Government.

(l) Procurement. The requirements of §3560.102(g), (j), and (k), and all other Agency requirements relating to procurement, bidding, identity-of-interest, cost-reasonableness, and construction management apply to any work or services paid out of reserve funds. Structural repairs and other significant work on major building systems such as heating or air conditioning must be done in accordance with the requirements of 7 CFR part 1924, subpart A.

§3560.307 Reports.

(a) Required reports. Borrowers must submit required reports using Agency-approved formats.

(b) Quarterly and monthly reports. The Agency may require quarterly or monthly reports to monitor financial progress when closer supervision is warranted.

§3560.308 Annual financial reports.

(a) General. Borrowers must submit annual financial reports that meet the requirements of this section. The annual financial reports to be submitted are the Multi-Family Housing (MFH) Project Budget with actual expenditures and the MFH Balance Sheet. Annual financial reports are due to the Agency within 90 days of the end of the borrower's fiscal year.

(1) Borrowers with 16 or more units in their housing project must base their annual financial reports on an engagement report completed according to agreed upon procedures established by the Agency as specified in paragraph (b) of this section. Borrowers must include the engagement report with their annual financial reports submitted to the Agency.

(2) Borrowers with less than 16 units in their housing project must submit annual financial reports using a limited scope engagement based on Agency approved procedures and certify that the housing meets the performance standards established in paragraph (c) of this section. Borrowers may use a CPA to prepare this report. For properties that prepare a limited scope engagement, the Agency may undertake random audits, once every two or three years.

(3) If a third party requires it, the borrower may have a CPA prepare an audit in accordance with generally accepted government auditing standards (GAGAS). Costs incurred to obtain this audit are an allowable project expense.

(b) Engagement requirements. Borrowers required to submit annual financial reports based on an engagement performed by a CPA must meet the following requirements:

(1) Borrowers must use an Agency approved engagement letter. Borrowers must submit the results of an engagement that examines specific records using agreed

upon procedures established by the Agency and that describes the borrower's performance in meeting the standards described in paragraph (c) of this section.

(2) The engagement will be initiated by the borrower using the Agency's engagement letter, which will specify the engagement program and establish the reporting requirements for the engagement.

(3) The engagement must be conducted by a CPA in accordance with American Institute of Certified Public Accountant (AICPA) Standards and Agency requirements.

(4) All engagement reports must be prepared for use by the Agency.

(c) Performance standards. Borrowers must ensure that:

(1) Required accounts are properly maintained and tracked separately;

(2) Payments from operating accounts are disclosed and accurately represented on financial reports;

(3) The reserve amount is at the authorized level and there are no encumbrances;

(4) Tenant security deposit accounts are fully-funded and are maintained in separate accounts and meet state and local requirements;

(5) Amount of payment of owner return was consistent with the terms of the applicable loan agreement;

(6) The borrower has maintained proper insurance in accordance with the requirements of §3560.105(b); and

(7) All financial records are adequate and suitable for examination.

(d) Other financial reports.

(1) Nonprofit and public borrower entities must submit audits in accordance with 7 CFR part 3052 that must also include the requirements set forth in the limited scope engagement.

(2) The Agency may require additional opinions of financial condition and compliance, such as audits, to assure the security of the asset, determine whether the housing project is being operated at a reasonable cost, or to detect fraud, waste, or abuse.

(3) Any audits independently obtained by the borrower also must be submitted to the Agency.

§3560.309 Advancement (loan) of funds to a RRH project by the owner, member of the organization, or agent of the owner.

(a) Prior written approval by the Servicing Office is required. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short-term in nature, a servicing plan may be developed and advances may be approved in accordance with the provisions set out in §3560.453 of this part. Justification will be based on the following:

(1) A review of the documented circumstances and the project operating budget before any funds are advanced (loaned). The financial position of the project must not be jeopardized.

(2) Funds are not immediately available from any of the following sources:

(i) Reserve funds;

(ii) Initial operating capital; and

(iii) An imminent rent increase.

(b) The funds will be applied to ordinary project operating and maintenance expenses.

(c) Interest may be charged or paid on the loan from project income; however, interest must be reasonable. The proposal may be denied if Rural Development financing can be provided to resolve the problem in a more cost-effective manner.

(d) No lien in connection with the loan will be filed against the property securing the Rural Development loan or against project income. The advance may show as an unsecured project liability on financial statements prepared for year-end reports until such time as it is authorized to be repaid.

(e) The payback of the advance (loan) may be permitted by the Servicing Official provided the terms and conditions were mutually agreed to by the borrower and Rural Development at the time of the advance and the financial position of the project will not be jeopardized. Payback should only be permitted on the advance when the Rural Development debt is current and the reserve requirements are being maintained at the authorized levels.

§§3560.310-3560.349 [Reserved]

§3560.350 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart H--Agency Monitoring

§3560.351 General.

This subpart contains policies for Agency monitoring of operations and management at multi-family housing (MFH) projects.

§3560.352 Agency monitoring scope, purpose, and borrower responsibilities.

(a) Scope of Agency monitoring activities. The Agency will review reports, records, and other materials related to the housing project, including borrower financial reports,

housing project records, and other communications. The Agency also will review material related to a housing project submitted by a tenant or other source. To assess conditions such as a housing project's physical condition, record keeping procedures, and operations and management activities, including borrower compliance with Federal, state, and local laws and Agency requirements, the Agency will conduct periodic on-site monitoring reviews of a housing project.

(b) Purpose of Agency monitoring activities. Agency monitoring activities are designed to assess borrower and tenant compliance with Agency requirements, and to:

(1) Ensure housing projects are managed in accordance with the goals and objectives of the Agency's MFH programs and are maintained in accordance with Agency requirements for affordable, decent, safe, and sanitary housing;

(2) Preserve the value of the Agency-financed housing projects;

(3) Detect waste, fraud, and abuse in housing project operations or management and to ensure the cost of operations and management are necessary and reasonable;

(4) Verify compliance with Affirmative Fair Housing Marketing requirements, Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans with Disabilities Act of 1990, other applicable Federal laws, and Agency requirements related to occupancy and tenant eligibility.

(c) Borrower responsibilities. The borrower is responsible for cooperating fully and promptly with Agency monitoring activities. Agency monitoring activities do not diminish borrower operation and management responsibilities and do not relieve borrowers from any Agency requirements including, but not limited to, borrower requirements to comply with:

(1) The terms of all agreements with the Agency, including the loan or grant agreement, assurance agreement, loan resolution, promissory note, mortgage, interest credit agreement, rental assistance agreement, mitigation measures contained in the environmental review document, and workout agreement;

(2) The requirements contained in this part;

(3) The requirements of Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended; section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans with Disabilities Act of 1990; and

(4) Applicable Federal, state, and local laws.

§3560.353 Scheduling of on-site monitoring reviews.

Generally, the Agency will provide the borrower prior notice of an on-site monitoring review and will conduct the on-site monitoring review in the presence of the borrower. However, the Agency may visit a housing project, without prior notice, to observe physical conditions, operations and management activities, or other borrower or tenant activities. In addition, the Agency may conduct on-site reviews without the presence of the borrower, the management agent, or other designated representative of the borrower.

§3560.354 Borrower response to monitoring review notifications.

The Agency will notify borrowers, in writing, whenever Agency monitoring activities result in deficiency findings or compliance violations. The monitoring review notification will describe the deficiencies findings or compliance violations and will specify a time period by which corrective action must be taken by the borrower. The notification will offer borrowers an opportunity to discuss the reported deficiency findings or compliance violations with the Agency and will explain enforcement actions that the Agency may take if corrective action is not taken within the time period specified in the monitoring review notification. When civil rights non-compliance is found, the State Civil Rights Coordinator or Manager (SCRC/M) will be notified. If voluntary compliance cannot be obtained, appropriate enforcement or remedial action will be taken.

§§3560.355-3560.399 [Reserved]

§3560.400 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart I--Servicing

§3560.401 General.

(a) Purpose. This subpart contains actions the Agency may take to service and collect loans or other debts owed by multi-family housing (MFH) borrowers. The loan servicing and other actions set forth are designed to protect Agency and tenant interests and assist borrowers in meeting program objectives.

(b) General servicing policies. Borrowers must repay loans or other amounts due to the Agency according to provisions specified in promissory notes, loan agreements and resolutions, mortgages, deeds-of-trust, assumption agreements, reamortization agreements, or other agreements executed between the borrower and the Agency.

(c) Special servicing actions. The Agency will not agree to any proposal for loan servicing or debt collection action other than actions consistent with this section, debt instruments, and other agreements. When payments due to the Agency from a borrower remain unpaid for more than 30 days after the due date, past due, after the Agency may initiate the special servicing actions described in subpart J of this part.

§3560.402 Loan payment processing.

(a) Predetermined Amortization Schedule System (PASS) requirements. All loans, except the loans specified in paragraph (c) of this section, must be closed and serviced using the PASS.

(b) Required conversion to PASS. Borrowers with Daily Interest Accrual System (DIAS) accounts must convert to PASS whenever a loan servicing action on the account involves a change in the loan rates or terms or whenever a subsequent loan to the borrower is closed.

(c) Exceptions. Seasonal farm labor housing loans and on-farm labor housing loans may be closed on DIAS, monthly, or annual payment schedules.

§3560.403 Account servicing.

(a) Payment due dates. Loan or other payments due to the Agency are due on the first day of each month unless otherwise established in the debt instrument or other agreement executed with the Agency.

(b) Payment application order. Loan payments will be applied to the borrower's account in the following order of priority:

(1) Amortized audit receivables. (i.e., amounts due to the Agency, over a period of time, as a result of a finding from an audit or other monitoring activity.)

(2) Unamortized audit receivables. (i.e., amounts due to the Agency, in a lump sum payment, as a result of a finding from an audit or other monitoring activity.)

(3) Late fees. (i.e., amounts due to the Agency as a result of late payments.)

(4) Amortized recoverable costs. (i.e., amounts due to the Agency, over a period of time, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(5) Unamortized recoverable costs. (i.e., amounts due to the Agency, in a lump sum payment, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(6) Overage. (i.e., amounts due to the Agency as a result of a tenant's tenant contribution being higher than basic rent.)

(7) Interest. (i.e., amounts due to the Agency as a result of scheduled interest on a loan and as a result of interest charged on unpaid delinquent principal amounts.)

(8) Principal. (i.e., amounts due to the Agency as the loan principal.)

(9) Advance payments. (Any funds remaining after disbursement of a payment to all other payment priorities will be applied to the borrower's account as an advance regular payment unless a borrower specifically designates, in writing, another application.)

(c) Late fees. If payments on a borrower's account, under PASS, are more than $15 delinquent after the close of business on the 10th day after the payment due date, a late fee will be charged to the borrower's account.

(1) Late fees charged to a borrower's account will equal 6 percent of the total regular payments due as specified in any promissory notes, assumption agreements, or reamortization agreements related to the borrower's account.

(2) Late fees are a borrower expense and must not be paid from housing project funds.

(3) The Agency may waive late fees for circumstances beyond a borrower's control and when a waiver is determined by the Agency to be in the best financial interest of the Federal Government.

(d) Interest on unpaid overdue principal. On the first day of the month following a payment due date, the Agency will charge interest at the note rate on any unpaid principal payment due according to the loan's amortization schedule (i.e., interest will be charged on delinquent principal). The interest charged on the unpaid principal payment due will be charged to the borrower in addition to the scheduled interest due on payments according to the loan's amortization schedule.

§3560.404 Final loan payments.

(a) Payoff statements. At the borrower's request, the Agency will provide a statement indicating the pay off amount necessary to pay the borrower's account in full.

(b) Final payments. A borrower's final loan payment must include repayment of all outstanding obligations to the Agency.

(1) Any supervised funds being held by the Agency will be applied to the borrower's account or, at the borrower's option, will be returned to the borrower following acceptance of final payment on all outstanding obligations.

(2) If a balance due remains on a borrower's account after Agency acceptance of a final payment, due to borrower error or fraud or Agency error, the Agency will initiate collection action in accordance with the unauthorized assistance collection procedures described in subpart O of this part.

(c) Final payment loans. Borrowers with loans for which the Agency approved an amortization period that exceeded the term of the loan may request a loan to finance the final payment in accordance with the requirements of §3560.74.

(d) Loan prepayment requests. If prepayment of an Agency loan is requested, the applicable preservation requirements of subpart N of this part, including the execution of any appropriate restrictive-use agreements, must be met prior to the Agency's acceptance of a final loan payment under the prepayment request.

(e) Payment forms. Final payments may be made by cashier's check, certified check, money order, bank draft, or other withdrawal instruments approved by the Agency.

(1) If borrowers use forms of payment requiring special handling, the borrower is responsible for the cost of the special handling.

(2) When payment is provided in a form that is not the equivalent of cash, the Agency will consider the payment to be received at the time the payment has been converted to cash and funds have been transferred to the Agency.

(f) Release of security instruments. The Agency will release security instruments, subject to applicable restrictive-use agreements referenced in subpart N of this part, when full payment of all outstanding obligations to the Agency has been received, accepted, and the funds have been transferred to the Agency.

(1) If the Agency and the borrower agree to settle an account for less than the full amount owed, the Agency will release security instruments when the borrower has paid in full all agreed upon obligations.

(2) Recording costs for the release of the security instruments will be the responsibility of the borrower, except where state law requires the mortgagee to record or file the satisfaction.

(g) Special circumstances--Refund of entire principal. If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of receipt of the refund.

§3560.405 Borrower organizational structure or ownership interest changes.

(a) General. The requirements of this section apply to changes in a borrower entity's organizational structure or to a change in a borrower entity's controlling interest. If 100 percent of a borrower entity's ownership interest is transferred, within a 12-month period, the change will be considered a housing project transfer and the provisions of §3560.406, which covers transfers or sales of housing projects, will apply.

(b) Agency requirements. Borrowers must notify the Agency prior to the implementation of any changes in a borrower entity's organizational structure. The Agency must give its consent prior to the implementation of changes in a borrower entity's controlling interest.

(1) Borrowers must submit written requests for Agency consent to the Agency at least 45 days prior to the anticipated effective date of the proposed organizational change. The request must document that the proposed changes will not adversely affect the program purposes or security interest of the Agency and will not adversely affect tenants.

(2) If the controlling interest change involves a transfer of interest to an entity not previously holding an ownership interest in the borrower entity, the request for consent must include a written certification, executed by the party receiving the ownership interest, certifying that the recipient of the ownership interest agrees to assume responsibilities and obligations required of a borrower as established in Agency program requirements including requirements in the promissory note, loan agreement, or other document related to Agency loans held by the borrower entity.

(3) The Agency will not take a consent request for a controlling interest change under consideration if the borrower's request fails to meet the requirements specified in paragraph (b)(2) of this section.

(c) Documentation of organizational structures and ownership interest. Borrowers must annually document their organizational structure and ownership.

(1) Documentation must be submitted with the annual financial reports required by §3560.308 and must reflect any changes made during the 12-month period preceding the submission of the annual financial reports.

(2) If no changes in a borrower entity's organizational structure or ownership were made during the 12-month period prior to submission of the annual financial reports, borrowers are not required to submit documentation, but must submit a statement certifying that no changes have been made in the documents on file with the Agency.

(3) Organizational structure and ownership documentation must include the following items:

(i) A current organization description reflecting all approved changes in the organizational structure of the borrower entity and listing the names, addresses, and tax identification numbers of all parties with an ownership interest in the borrower entity; and

(ii) A written statement by the borrower certifying that the changes in the borrower entity's organizational structure or ownership interests were completed in compliance with state and local laws and in accordance with organizational requirements of the borrower entity.

§3560.406 MFH ownership transfers or sales.

(a) General. The provisions of this section apply to ownership transfers or sales (e.g., title transfers) involving an Agency financed housing project. The provisions cover situations where Agency loans are being assumed as a part of a housing project transfer or sale.

(b) Agency consent requirements. Agency consent must be obtained prior to an ownership transfer or sale and Agency consent will only be given when the transfer or sale is in the best interest of the Federal Government. Any ownership transfer or sale without the consent of the Agency will be considered a default and will be handled in accordance with subpart J of this part.

(1) Priority consideration will be given to ownership transfers or sales needed to remove a hardship to the borrower that was caused by circumstances beyond the borrower's control.

(2) Ownership transfers or sales with an assumption of debt at an amount less than the borrower's debt amount will only be approved by the Agency when all persons in the borrower entity who are transferring their ownership interest or are involved in the selling of the property are not part of the transferee organization.

(c) Consent request requirements. Borrowers must submit written requests for Agency consent to an ownership transfer or sale of a housing project to the Agency at least 45 days prior to proposed ownership transfer or sale date. The consent request must document that the proposed transfer or sale meets the requirements of paragraph (d) of this section and must include the following items:

(1) A statement disclosing any identity-of-interest between the borrower and the party to which the housing project ownership is being transferred or sold.

(2) A statement certifying that the housing project's financial accounts are funded at required levels, less authorized withdrawals, and that payments due for operation and maintenance expenses, tax assessments, insurance premiums, any required tenant security deposit accounts, and other obligations incurred as a part of the housing project operations are paid in full with no overdue balances or a statement explaining the housing project's financial situation and the reasons for overdue payments or under funded accounts.

(3) A proposed housing project budget covering the partial year, if applicable, and first full year operation following the ownership transfer or housing project sale.

(4) A written statement, signed by the proposed transferee or buyer, certifying that the transferee or buyer will assume the borrower responsibilities and obligations specified in Agency program requirements including requirements in a promissory note, loan agreement or other documents related to Agency loans held by the borrower entity.

(5) A certification from the borrower and the proposed transferee or buyer that the borrower does not and will not have a reversionary interest in the housing project.

(d) Requirements for ownership transfers or sales. An ownership transfer or sale of a housing project with an assumption of Agency loans by the transferee or buyer must comply with the following conditions:

(1) The transferee or buyer must be an eligible borrower under the requirements established by subpart B of this part;

(2) The transferee or buyer must agree to set basic rents at the housing project covered by the assumed loans at levels that do no exceed conventional rents for comparable units in the area, except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150% of the comparable rent for conventional unit rent level; and

(3) The value of the housing project covered by the loans to be assumed, at the time of an ownership transfer or sale, must be sufficient to ensure that all Agency loans being assumed and all subsequent loans being offered as a part of the transfer or sale can be secured to a level that fully protects the Agency's interest. Loans from third-party sources that are not dependent on project revenue for payment will not be included in this determination.

(i) If the total value of the loans being offered as a part of an ownership transfer or sale is $100,000 or less, the security value of the housing project may be determined through either: An Agency review of monitoring reports conducted in accordance with the requirements in subpart H of this part or an appraisal paid for by the borrower and conducted in accordance with subpart P of this part.

(ii) If the total value of the loans being offered as a part of an ownership transfer or sale exceeds $100,000, the security value of the housing project must be determined through an appraisal obtained by the Agency and conducted in accordance with subpart P of this part.

(iii) The Agency may approve a loan write-down, in accordance with §3560.455, prior to an ownership transfer or sale to reduce the amount of debt being assumed by the transferee or buyer.

(4) Prior to Agency approval of an ownership transfer or sale, the appropriate level of environmental review in accordance with 7 CFR part 1970 must be completed by the Agency on all property related to the ownership transfer or sale. If releases of or contamination from hazardous substances or petroleum products is found on the property, the finding must be disclosed to the Agency and the transferee or buyer and must be taken into consideration in the determination of the housing project's value. (Revised 04-01-16, SPECIAL PN.)

(5) All immediate and long-term repair and rehabilitation needs must be identified by a capital needs assessment. The reserve requirements for the housing project will be reviewed by the Agency and adjusted, if necessary, to adequately cover the cost of addressing the property's capital needs. The Agency may approve the release of the current reserve amount to the transferor provided the transferee agrees to deposit the amount to cover the project's immediate needs into the reserve account at closing.

(6) The borrower and transferee must disclose to the Agency all terms, conditions, or other considerations related to the ownership transfer or sale. All side or other agreements must be disclosed and all sources and uses of funds related to the ownership transfer or sale must be disclosed.

(7) An agreement must be signed between the borrower and the transferee listing all repairs known by the borrower to be necessary to bring the housing project into compliance with Agency requirements for decent, safe, and sanitary housing as listed in subpart C of this part.

(i) The agreement must include repairs required to correct compliance violations cited in a compliance violation notice issued by the Agency.

(ii) The agreement must specify whether each repair listed will be completed by the borrower prior to the ownership transfer or by the transferee in accordance with a workout agreement developed in accordance with the requirements of §3560.453 and executed between the transferee or buyer and the Agency.

(8) A civil rights compliance review, as required by 7 CFR part 1901, subpart E, will be conducted by the Agency prior to the ownership transfer or sale.

(9) During or immediately after the transfer, a review of the property must be conducted to ensure that it complies with or will comply with section 504(c) of the Americans with Disabilities Act (ADA), which covers accessibility requirements, and the Title VI of the Fair Housing Act of 1968.

(10) A transferee must ensure that tenant certifications in compliance with subpart D of this part for all occupied rental units are on file with the Agency.

(11) A transferee must comply with insurance and bonding requirements established in subpart C of this part at the time of the transfer.

(12) A transferee must agree to submit financial reports to the Agency according to subpart G of this part.

(13) A transferee must establish that there are no liens, judgments, or other claims against the housing project other than those by the Agency and those to which the Agency has previously agreed.

(14) A limited profit Rural Rental Housing transferee's initial investment and return on investment will remain the same as that originally provided to the transferor unless:

(i) The property is transferred to a non-profit entity and the return on investment is eliminated; or

(ii) The transferee contributes additional funds for repair or rehabilitation and the Agency agrees to recognize a higher initial investment.

(e) Equity payments. The Agency will withhold any equity payment due to the borrower, as part of an ownership transfer or sale, if any of the following conditions exist:

(1) The borrower's indebtedness to the Agency has not been paid in full or is not being assumed by the transferee. The Agency will require that all or part of an equity payment be applied against other Agency loans owed by the borrower if payments on the other loans are not current.

(2) Any non-Agency prior liens against a housing project are not paid in full.

(3) Any housing project financial accounts are not funded at required levels, less authorized withdrawals, or any payments due for operation and maintenance expenses, tax assessments, insurance premiums, tenant security deposits or other obligations incurred as a part of housing project operations are not paid in full.

(4) Any management deficiencies cited in a compliance violation notice issued by the Agency to the borrower have not been corrected or the housing project is not operating under an approved management plan or, if applicable, an approved management agreement.

(5) Any operation and maintenance deficiencies cited in compliance violation notices issued by the Agency have not been corrected or are not scheduled for correction in a workout agreement developed in accordance with the requirements of §3560.453.

(6) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or other Federal, state, or local agencies for violations of Fair Housing or Equal Opportunity requirements.

(7) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or any other entity involved in the financing of the housing project for misappropriation of funds.

(f) Equity payment funding sources. Equity may be provided in cash or through a loan. If a full equity payment to the transferor is not paid at the time of the ownership transfer or sale or has not been paid through an Agency equity loan or third-party equity loan approved by the Agency to the borrower, the transferee must certify that equity payments due to the borrower will be paid from sources other than housing project's funds and must identify the sources of such payments.

(g) Restrictive-use requirement. Transferees assuming Agency loans, including loans approved prior to December 21, 1979, will be required to execute a restrictive-use agreement that contains the language specified in §3560.662. The restrictive-use agreement will require the housing project to be used for program purposes for a specified period of time beyond the date that the ownership transfer or sale is closed. When an equity loan is involved at the time of transfer, the restrictions will be for 30 years.

(h) Subsequent loans. The Agency may approve a subsequent loan or permit a loan from a third-party source in conjunction with an ownership transfer or sale of a housing project. The subsequent loan may be in the form of a junior or parity lien.

(1) Subsequent loans on a housing project proposed in conjunction with an ownership transfer or sale must be requested and processed in accordance with the Agency loan origination requirements in subpart B of this part.

(2) The Agency may amortize the subsequent loan over a period not to exceed the remaining economic life of the housing or 50 years, whichever is less.

(3) The Agency may extend the term of the existing loan to a period not to exceed 30 years or the remaining economic life of the housing, whichever is less.

(i) Loan assumption interest rates. The interest rate for Agency loans assumed in conjunction with an ownership transfer or sale will be determined as follows:

(1) The interest rate for all loans, except farm labor housing loans, will be set at the lower of:

(i) The note rate of the existing Agency loan;

(ii) The Agency note rate on the day the transfer is approved;

(iii) The Agency note rate on the day the transfer is closed; or

(iv) If the rents are increased due to a transfer, the transfer will be done under new rates and terms when the Agency determines that it is in the best interest of the government. Subsequent loan may be in the form of a senior, junior or parity lien or soft second.

(2) The interest rate on farm labor housing loans will be the rate specified in the note, except that loans transferred to public bodies, nonprofit organizations of farm workers, and broadly-based nonprofit corporations for farm labor housing purposes may be at a one percent interest rate regardless of the rate specified in the note if the Agency determines that such a reduction is necessary to maintain affordable rental rates for tenants.

(j) Loan assumption terms. The amount of the loan balance that may be assumed through an ownership transfer or sale must not exceed the security value of the housing project determined according to §3560.406(d)(3)(i).

(1) The Agency may reamortize a loan assumed e time of the transfer or sale, to a monthly payment amortization and will be made subject to PASS. When on- or off-farm labor housing projects are involved in an ownership transfer or sale, the related loans may be transferred on a DIAS basis or converted to PASS if the Agency determines that such a conversion will not be detrimental to the operation of the farm labor housing.

(k) Processing ownership transfers or sales.

(1) At the time of the transfer, the Agency will require the borrower to transfer all equipment, related facilities, and housing project financial accounts to the transferee including the operation and maintenance account, reserve account, tenant security deposit account, tax and insurance escrow accounts.

(i) Any funds remaining in a rental assistance contract not dispersed by the transferor will be assigned to the transferee unless the rental assistance is not needed for tenants or another form of rental subsidy is to be used.

(ii) Any rental assistance determined to be unnecessary will be reassigned to other housing projects in accordance with the provisions of subpart F of this part.

(2) The Agency will require that appropriate loan documents are executed by the transferee. The Agency may require such documents to be referenced in security instruments (e.g., mortgage or deed of trust).

(3) If all of a borrower's outstanding Agency debt is not assumed or paid off at the time of the transfer or sale, the Agency will not release a borrower from liability unless the Agency determines that the borrower is unable to pay the remaining debt from assets taken as security through the debt settlement procedure in accordance with §3560.457.

(l) Ownership transfers or sales under special rates, terms, and conditions. Housing projects may be transferred or sold to entities that do not meet borrower eligibility requirements for the type of loans being assumed. However, such a transfer or sale will only be considered when it is determined by the Agency to be in the best interest of the Federal Government and the objectives of the original loan can no longer be met. The following special rates, terms, and conditions will apply to such situations.

(1) The transferee makes a down payment of at least 10 percent of the remaining loan balance to be assumed.

(2) The transferee has the ability to pay the Agency debt.

(3) Monthly or annual installments will be amortized over the term of the loan and the interest rate will be at a rate of interest at least one percent higher than the interest rate offered to eligible borrowers as specified in paragraphs (i)(1) or (2) of this section.

§3560.407 Sales or other disposition of security property.

(a) General. Borrowers must obtain Agency approval prior to selling or exchanging all or a part of, or an interest in, property serving as security for Agency loans. Agency approval also must be requested and received prior to the granting or conveyance of rights-of-way through property serving as security property. Agency approvals of sales or other dispositions of security property are not subject to the requirements outlined in 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)

(b) Request requirements. Requests for Agency approval of transactions related to security property must document that the following conditions will be met.

(1) The borrower's ability to repay the Agency debt will not be impaired;

(2) The transaction will not interfere with the successful operation of the housing project or prevent the borrower from carrying out the purpose for which the loan was made.

(3) The monetary or other consideration offered in the transaction is equal to or greater than the market value of the security property being disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed with minimal or no consideration being offered if:

(i) The value of the security property will not be reduced;

(ii) The suitability of the security property for the intended purpose will not be impaired; and

(iii) The easement is granted to allow the borrower to develop additional lots or units that will be integrated into the housing project or for enhancement of streets, utilities or other services provided by a public body.

(4) The property that will remain as security for Agency loans, after any transaction related to security property, will fully secure the borrower's debt to the Agency.

(5) Borrowers must report to the Agency the total of all proceeds derived from the sale or other disposition of property serving as security for Agency loans. The proceeds from the disposition of the security property will be used for purposes approved by the Agency.

§3560.408 Lease of security property.

(a) General. Borrowers must obtain Agency approval prior to entering into a lease agreement related to any property serving as security for Agency loans. Agency approvals of lease agreements are considered loan servicing actions under 7 CFR part 1970, and as such do not require additional NEPA analysis and documentation.

(b) Leases to public housing authorities. Borrowers may not lease all or part of their housing facilities to a housing authority. Lease agreements in place prior to the effective date of this regulation may be continued provided that leases are in a form acceptable to the housing authority and are on terms that will enable the borrower to comply with Agency program requirements, to meet Agency program objectives, and make loan and other required payments to the Agency on an Agency approved schedule.

(c) Lease of a portion of the security property. The Agency may, subject to the applicable provisions governing loan purposes found in of §3560.53, §3560.553 and §3560.603, approve the leasing of facilities related to a housing project (e.g., central kitchens, recreation facilities, laundry rooms, and community rooms) when the borrower will continue to operate the facilities for the purposes for which the loan was made. Agency approval is not required for leases with a term of less than 30 days. The Agency will only approve a lease with a term over 30 days if the following conditions are met:

(1) The lease is in the best interest of the borrower, the tenants, and the Federal Government.

(2) The amount of the consideration agreed to in the lease is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest.

(3) All compensation and considerations, whether payments, a share of proceeds, or improvements to the property paid for by the lessee, must be disclosed to the Agency. No payments or compensation for entering into a lease shall flow to the borrower or any identity-of-interest related to the borrower.

(4) The lease provides at its termination for the restoration of the leased space to its original condition or a condition acceptable to the owner and the Federal Government.

(5) Consent to the lease will not exceed 3 years at a time unless the Agency determines that a longer lease is advantageous to the borrower, the tenants, and the Federal Government.

(6) When another lienholder's mortgage requires that lienholder's consent to a lease, the borrower must obtain written consent from the lienholder before the Agency will consider approving the lease.

(d) Mineral leases. Mineral leases will be handled according to 7 CFR 3550.159 except that all references to County Supervisor will be construed to mean District Director when applied to the MFH Programs.

§3560.409 Subordinations or junior liens against security property.

(a) General. Borrowers must obtain Agency consent prior to entering into any financial transaction that will require a subordination of the Agency security interest in the property, or lien subordination, (*i.e.*, granting of a prior interest to another lender.) Prior to Agency consent, environmental review requirements must be completed in accordance with 7 CFR part 1970. Borrowers must use an Agency approved lien subordination agreement. (Revised 04-01-16, SPECIAL PN.)

(1) If a lien is placed against property serving as security for an Agency loan without prior Agency consent, the Agency will declare the borrower to be in

default and will pursue liquidation of the borrower's loans in accordance with the procedures specified in §3560.457, unless an agreement can be reached between the borrower and the Agency to work out removal of the lien or post approve the lien.

(2) Subordinations or junior liens need not encompass the entire site, (e.g., a subordination or junior lien requested to permit an interim lender to advance construction funds may only cover the portion of the site proposed for construction.)

(3) The subordination or junior lien must be for a specific amount.

(4) The subordination or junior lien must not adversely impact the Agency's ability to service the loan according to the requirements of this part.

(b) Consent request requirements. Borrowers proposing to have the Agency subordinate its interest to another lender or to give a creditor a junior lien against property serving as security for an Agency loan must submit a consent request to the Agency. The consent request must document the following:

(1) The action will enable the borrower to obtain financial resources for improvements or repairs on the security property that are consistent with the purposes of the Agency loan secured by the property.

(2) The action will not adversely impact the borrower's financial condition and the borrower's ability to repay the Agency loan being secured by the property.

(3) The action will not result in basic rents at the security property that exceed conventional rents for comparable units in the area.

(4) The terms and conditions of the credit to be secured by the subordination or junior lien are not expected to adversely affect the borrowers ability to meet the terms and conditions of the Agency loan secured by the property.

(5) The proposed use of the funds obtained through the granting of a subordination or junior lien will not adversely affect the borrower's ability to meet Agency program requirements or to operate and manage the housing project in a manner consistent with program objectives.

(6) The creditor receiving the “subordination” of interest in the property or the junior lien will agree that a foreclosure or acceptance of a deed-in-lieu of foreclosure will not be initiated without at least 30 days prior notice to the Agency.

(7) The subordination or junior lien is not being secured with any funding from housing project financial accounts.

(8) The “subordination” of interest or junior lien will not cause the debt from all sources to exceed the value of the security property.

(9) The transaction related to the placement of a “subordination” of interest or junior lien against the property serving as security for an Agency loan is in the best interest of the Federal Government.

(c) Required conditions for subordinations and junior liens. Subordinations of interest in or junior liens against property serving as security for an Agency loan may be approved by the Agency only if they improve a borrower's financial condition and allow for improvements or repairs that are consistent with the purposes of the Agency loan secured by the property.

(1) Farm Labor Housing loans on farm tracts may be subordinated for essential farm improvements and operations.

(2) Any proposed development must be planned and performed according to 7 CFR part 1924, subpart A, or in a manner directed by the other lienholder that meets the objectives of 7 CFR part 1924, subpart A.

(d) Other liens against a property or other assets.

(1) Borrowers must not enter into any agreements to place a lien on a housing project or any equipment related to a housing project without prior Agency approval and unless the following conditions are met:

(i) The transaction will not adversely affect the Agency's security position;

(ii) The lien is not related to a non-program eligible action;

(iii) The items to be acquired by the funding related to the lien is needed for the operation of the property; and

(iv) The financing arrangements are otherwise sound.

(2) In cases where the above criteria are met, borrowers must complete and provide the Agency a copy of the financing statement, loan document, or contract, as applicable, as well as a security agreement acceptable to the Agency.

§3560.410 Consolidations.

(a) General. With Agency approval, loans, loan agreements, or loan resolutions may be consolidated to reduce the administrative burden (i.e., record keeping, budgeting), to improve the cost effectiveness and efficiencies of housing project operations, and to effectively utilize facilities common to housing projects.

(b) Loan consolidations. Loan consolidations will only be considered when:

(1) Multiple loans to the one borrower entity are being transferred to a different borrower entity in accordance with §3560.406, or

(2) One borrower entity has an initial loan and one or more subsequent loans for the same housing project and all the loans were closed on the same date and with the same rates and terms.

(c) Loan agreement or loan resolution consolidations. Loan agreements or loan resolutions may be consolidated, even if the loans related to the agreement or resolution are not consolidated, to allow borrowers to comply with reporting, accounting, and other Agency requirements as a single housing project.

(1) The loan agreements or loan resolutions may only be consolidated when they are related to loans made for the same purposes, to the same borrower, and operating under the same type of interest credit, if applicable.

(2) All of a borrower's loan accounts must be current after the loan agreement or loan resolution consolidation is processed, unless otherwise approved by the Agency.

§§3560.411-3560.449 [Reserved]

§3560.450 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart J--Special Servicing, Enforcement, Liquidation, and Other Actions

§3560.451 General.

This subpart contains special servicing, enforcement, liquidation, and other actions that the borrower may request or the Agency may implement when compliance violations, monetary defaults, or non-monetary defaults cannot be resolved through regular servicing.

(a) Agency obligations. The Agency is under no obligation to offer or agree to any special servicing actions.

(b) Relationship to workout agreements. Special servicing actions may be implemented either as a part of a workout agreement, developed in accordance with §3560.453, or as an action approved by the Agency separate from a workout agreement unless indicated otherwise in this subpart.

§3560.452 Monetary and non-monetary defaults.

(a) General. Borrowers are in default when they have received a compliance violation notice, issued in accordance with §3560.354, and have failed to correct the compliance violation identified in the compliance violation notice within the time period specified in the notice. Compliance violations include, but are not limited to, violations of promissory note provisions, loan or grant agreement provisions, regulatory, or other Agency requirements, including requirements imposed on a borrower through a workout agreement developed in accordance with §3560.453.

(b) Monetary defaults. A monetary default exists when any amount due to the Agency or a third party (such as real estate taxes and insurance) under a promissory note, loan or grant agreement, workout agreement, or other agreement remains due more than 30 days after the due date.

(c) Nonmonetary defaults. A nonmonetary default exists when a borrower fails to correct a compliance violation, other than a monetary amount past due, within the time period specified in a compliance violation notice issued in accordance with §3560.354. Nonmonetary defaults include, but are not limited to, failure to:

(1) Operate and manage a housing project in accordance with the Agency approved management plan or Agency requirements;

(2) Maintain the physical condition of a housing project in a decent, safe, and sanitary manner and in accordance with Agency requirements;

(3) Keep general operating expense, reserve, and other financial accounts related to a housing project at required funding levels;

(4) Occupy rental units with eligible tenants, unless granted an exception by the Agency;

(5) Charge correct rents or to correctly calculate net tenant contributions, utility allowances, or rental assistance payments or to properly administer the Agency rental assistance assigned to the housing project;

(6) Submit required annual financial reports to the Agency within time periods specified in §3560.308;

(7) Submit management plans, leases, occupancy rules, and other required materials to the Agency in accordance with Agency requirements; and,

(8) Comply with applicable Federal laws including laws related to civil rights, fair housing, disabilities, and environmental conditions.

(d) Default notice. When borrowers are in default, the Agency will notify borrowers, in writing, that they are in default. The default notice will identify the compliance violation that led to the default, will specify actions necessary to cure the default, and will establish a date by which the default must be cured to preclude Agency initiation of enforcement actions, liquidation, or other actions.

(e) Agency action. If a borrower fails to cure a default within the time period specified in the default notice, the Agency may initiate the enforcement actions described in §3560.461 or liquidation as described in §3560.456. Also, Agency compliance violation notices and related default notices may be referred to Federal, state, and local agencies with jurisdictions related to the violations for handling, in accordance with their requirements.

§3560.453 Workout agreements.

(a) General.

(1) Prevention or resolution of compliance violations or default cures are a borrower's responsibility.

(2) A borrower may develop and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

(3) A borrower developed workout agreement may propose, but is not limited to, the following actions:

(i) A combination of one or more of the special servicing actions outlined in §§3560.454 and 3560.455;

(ii) A change in operations and management at a housing project; or

(iii) A commitment of additional financial resources to the housing project with the amount and source of the additional resources to be committed to the housing project specifically identified.

(b) Workout agreement approval.

(1) The Agency is under no obligation to approve a workout agreement as submitted by a borrower or to act with forbearance when a housing project is in monetary or non-monetary default.

(2) Borrower developed workout agreements may not be implemented until the borrower receives written approval from the Agency.

(3) The Agency will only approve a workout agreement if the Agency determines that the actions proposed are likely to prevent or correct compliance violations or cure a default and approval is in the best interest of the Federal Government and tenants.

(4) The Agency will only approve a workout agreement if the proposed actions are consistent with the borrower's management plan. If proposed actions are not consistent with the borrower's management plan, applicable revisions to the borrower's management plan must be made before approval of the workout agreement is given.

(c) Workout agreement required content.

(1) Workout agreements submitted to the Agency for approval must be in writing and signed by the borrower. Workout agreements must describe proposed actions in sufficient detail to demonstrate the likelihood of the actions to prevent or correct compliance violations or cure defaults.

(2) At a minimum, workout agreements must include the following.

(i) The name and address of the housing project, project number, borrower's tax identification number, and other information necessary to identify the housing project.

(ii) A description of the potential or actual compliance violation or default situation, including an explanation of related causes, such as cash flow concerns, budget revisions, deferred maintenance, vacancies, or violations of statutes.

(iii) A definition and description of the housing project's market area, including information on housing availability, rents, and vacancy rates in the market area.

(iv) A description of the proposed actions to prevent or correct compliance violations or to cure defaults along with a date specific schedule indicating when interim and final actions will be taken to correct the compliance violation or cure the default.

(v) A description of financial and other resources necessary to prevent or correct the compliance violation or cure the default including an identification of the sources for such resources.

(d) Workout agreement budgets. Budget revisions submitted as a part of a workout agreement for a housing project experiencing cash flow problems must prioritize cash disbursements in the following order:

(1) Prior lienholder, if any;

(2) Critical operating and maintenance expenses, including taxes and insurance;

(3) Agency debt payments;

(4) Reserve account requirements; and

(5) Other authorized expenditures.

(e) Workout agreement terms and cancellation.

(1) Workout agreements shall be in effect for no longer than a 2-year time period, beginning on the date of Agency approval. If an approved workout agreement calls for actions that extend beyond a 2-year period, borrowers must submit an updated and, if necessary, revised workout agreement to the Agency for approval. The updated workout agreement must be submitted to the Agency, 30 days prior to the expiration of the workout agreement in effect.

(2) The Agency may cancel a workout agreement at any time if the borrower fails to comply with the terms of the agreement. The Agency will provide notice to the borrower upon cancellation of the workout agreement.

§3560.454 Special servicing actions related to housing operations.

(a) Changing rents or revising budgets. The Agency may approve a borrower request for a rent change, rent incentives, or a revised budget, at any time during a housing project's fiscal year.

(b) Occupancy waivers. If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by allowing the borrower to accept as tenants persons with incomes above the income eligibility standards specified in §3560.152(a), the Agency, in writing, may grant the borrower an occupancy waiver to allow such persons as tenants. Occupancy waivers will be in effect only during the time period specified by the Agency when the waiver is granted. In addition, borrowers must rent to all eligible applicants on the housing projects waiting list prior to accepting persons with incomes above the Agency standards as tenants.

(c) Additional rental assistance (RA). If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by increasing the amount of RA allocated to the housing project, the Agency, subject to available funds,

may offer the housing project RA as a means of preventing or correcting a compliance violation or curing a default.

(d) Special note rents. When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may approve a rent less than the note rent to attract and keep tenants whose incomes, according to the formula in §3560.203, would require them to pay the note rent. The reduced rent is called a Special Note Rent (SNR) and, as noted in §3560.210, approval of an SNR may affect approvals of loan proposals submitted to the Agency for the market area where the SNR is in effect.

(1) An SNR rent may only be requested as a part of a proposed workout agreement and must include documentation of market conditions, the housing project's vacancy rates, evidence of marketing efforts, and other concerns necessitating the request for an SNR.

(2) Borrowers must forego the annual return to owner for each housing project's fiscal year that an SNR is in effect for all or part of a fiscal year at a housing project.

(3) SNR's may be increased, decreased, or terminated any time during a housing project's fiscal year when market conditions, vacancy rates, or other concerns that necessitated the SNR warrant a change.

(4) In addition to any state lease law requirements that might be related to the implementation of an SNR, the borrower must notify each tenant of any change in rents or utility allowances that result from approval of an SNR, in accordance with §3560.205(c) and must submit the appropriate budget changes to the Agency for approval.

(e) Termination of management agreement. If the Agency determines that a compliance violation or loan default was caused, in full or in part, by actions or inactions of the housing project's management agent, the Agency will require the borrower to terminate the management agreement with that agent, or in the case of a borrower managed housing project, to enter an agreement with a third-party non-identity of interest management agent, unless the borrower and the Agency agree on a written plan to prevent reoccurrence of the violation. Housing project funds may not be used to pay a management fee to a management agent after the Agency has directed the borrower to terminate a management agreement with that agent, except during an Agency approved transition period.

§3560.455 Special servicing actions related to loan accounts.

(a) General. To prevent or correct a compliance violation or to prevent or cure a default in a situation that cannot be resolved through regular servicing, the Agency may approve a deferral of loan payments or a loan restructuring. Nothing herein precludes the Agency from initiating appropriate legal action to correct a compliance violation if the Agency determines such action is more in the Government's interest than entering into a special servicing agreement as provided for in this section. Procedures for debt collection are discussed in §3560.460. As part of a workout agreement, the Agency may agree to accept less than full monthly payment installments due on an Agency loan for a specified period of time, not to exceed the effective period of the workout agreement.

(b) Loan reamortizations. A loan reamortization is a restructuring of loan terms and conditions over a period of time that does not exceed the remaining useful life of the housing project.

(1) Loan reamortizations will only be approved when they are in the best interest of the Federal Government and tenants and when the following conditions are met.

(i) The Agency determines that the borrower will be unable to meet their obligations without a reduction in monthly payment installments; and

(ii) The Agency is satisfied that the security, including the potential income for debt service, will be adequate to protect the Agency's interest over the term of the reamortization and that the reamortization will not adversely affect the Federal Government's lien priority.

(2) If the Agency approves a reamortization of a loan under this section, it will be at the existing note rate, or the current interest rate at the time of reamortization closing or approval, whichever is less.

(3) Loan reamortization may be used to:

(i) Restructure loan repayments to prevent or correct a compliance violation or cure a default caused by circumstances beyond the borrower's control in situations where the borrower is otherwise in compliance with Agency requirements;

(ii) Repay principal, outstanding interest, overage, and advances made by the Agency for recoverable cost items when less than full payments were authorized under the provisions of an Agency approved workout agreement;

(iii) Restructure a borrower's loan payments in conjunction with an incentive package developed in accordance with §3560.656 to prevent prepayment of the loan;

(iv) Restructure an existing loan in conjunction with a subsequent loan for rehabilitation; or

(v) Restructure remaining debt when a portion of the property serving as loan security is sold and there is a need to reestablish the financial stability of the housing project.

(c) Loan writedowns. A loan writedown is a reduction of a borrower's debt approved by the Agency.

(1) Loan writedowns will only be approved when they are in the best interest of the Federal Government and when the following conditions exist:

(i) Sound management of the housing project is evident or sound management practices are proposed for correction in accordance with an Agency approved workout agreement; and

(ii) The housing project's financial stability is being affected by conditions beyond the borrower's control, such as market weaknesses, unforeseen site problems, or natural disasters.

(2) Prior to Agency approval for a loan writedown, the borrower must obtain an appraisal of the housing project that concludes the 'as-is' market value, subject to restricted rents, conducted in accordance with subpart P of this part. The Agency will not approve a loan write-down unless the appraisal indicates the Federal Government's interests are secured at the proposed writedown level.

(3) Any writedown will be conditioned on a finding that the borrower does not have the ability to pay a higher loan payment, even if the loan is reamortized.

(4) Loan writedowns may be used to allow for a loan transfer and assumption for less than the total amount of outstanding debt.

§3560.456 Liquidation.

Prior to any servicing action which might lead to the acquisition of real property by the Agency, the Agency must complete a due diligence report to assess any potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products. The borrower must cooperate with the Agency in the development of this report.

(a) Before acceleration. Before accelerating a project loan, the Agency will consider the possibility that the borrower is forcing an acceleration to circumvent the prepayment process. If it is found that this is the borrower's motivation, the Agency will consider alternatives to acceleration, such as suing for specific performance under loan and management documents.

(b) Acceleration. When a borrower is in monetary or non-monetary default, the Agency will accelerate the loan unless the Agency decides other enforcement measures are more appropriate.

(1) If the borrower does not pay the full account balance and meet the other terms of the acceleration notice within the time period set forth in the acceleration notice, the Agency will foreclose or acquire the security property through deed in lieu of foreclosure.

(2) The Agency will suspend interest credit and rental assistance.

(3) The Agency will not accept partial payment of an accelerated loan unless required by state law.

(c) Voluntary liquidation. After acceleration, borrowers may voluntarily liquidate through either of the following mechanisms:

(1) Deed in lieu of foreclosure. RHS may accept a deed in lieu of foreclosure to convey title to the security property only after the debt has been accelerated and when it is in the Government's best interest.

(2) Offer by third party. If a junior lienholder or cosigner makes an offer in the amount of at least the net recovery value, RHS may assign the note and mortgage after all appeal rights have expired.

(d) Foreclosure.

(1) The Agency will initiate foreclosure when a borrower is in monetary or non-monetary default and foreclosure is in the best interest of the Federal Government.

(2) When a junior lienholder foreclosure does not result in payment in full of the Agency debt but the property is sold subject to the Agency lien, the Agency will liquidate the account.

(e) Acquisition of chattel properties.

(1) The Agency will accept voluntary conveyance of chattel property only when the borrower can convey ownership free of other liens and the Agency has agreed to release the borrower from further liability on the account.

(2) If the Agency decides to accept an offer of voluntary conveyance of chattel property, the borrower must provide an itemized listing of each chattel property item being conveyed and provide title to vehicles or other equipment, where applicable.

§3560.457 Negotiated debt settlement.

(a) Borrower proposals to settle debt. A borrower who cannot pay the full amount of loan payments may propose an offer to settle an outstanding debt for less than the full amount of that debt. The Agency may approve a negotiated debt settlement only in cases where a default is evident and doing so is in the best interest of the Federal Government and tenants.

(b) Required information. Borrowers requesting debt settlement must submit complete and accurate information from which a full determination of financial condition can be made. Debt settlement offers will not be approved by the Agency unless the financial information submitted by the borrower indicates that the borrower will be able to make the debt settlement payments as proposed.

(c) Effective date of approval. Debt settlement offers will not be accepted until the borrower receives written approval from the Agency.

(d) Appraisal requirement. No debt settlement offer will be accepted for less than the net recovery value of the security as determined by a licensed appraiser or other qualified official, and concurred in by the Agency's qualified appraisal review official or other qualified official.

(e) Disposition of security prior to offer. Borrowers are not required to dispose of security prior to making a debt settlement offer. However, if a borrower has disposed of security prior to making a debt settlement offer, the proceeds from the disposed security must be applied to the borrower's account prior to any negotiations on the debt settlement offer.

(f) Final release condition. Upon full payment of the approved debt settlement, the Agency will release the borrower from liability.

§3560.458 Special property circumstances.

(a) Abandonment. When the Agency determines that a borrower has abandoned security for a loan under this part, the Agency will take the steps necessary to protect the Federal Government's interest in the security. Costs associated with managing abandoned property are the responsibility of the borrower and will be charged to the borrower's account until liquidation is completed.

(b) Other security. The Agency will service security such as collateral assignments, assignments of rents, Housing Assistance Payments Contracts, and notices of lienholder interest according to acceptable practices in the respective states.

(c) Taking of additional security to protect Agency interests. The Agency may require borrowers to provide additional security in the form of real estate, cash reserves, letters of credit, or other security when needed to improve the chances that the Agency will not suffer a loss, and when:

(1) The account is in default; or

(2) The property has not been properly managed or maintained.

(d) Due diligence. When the Agency has completed an environmental site assessment in accordance with 7 CFR part 1970, and decides not to acquire security property through liquidation action or chooses to abandon its security interest in real property, whether due in whole or in part, to releases of or the presence of contamination from hazardous substances, hazardous wastes, or petroleum products, the Agency will provide the appropriate environmental authorities with a copy of its environmental site assessment. (Revised 04-01-16, SPECIAL PN.)

§3560.459 Special borrower circumstances.

(a) Deceased borrower, bankruptcy, insolvency, and divorce actions. The Agency will address borrower accounts affected by special circumstances such as death, bankruptcy, insolvency, and divorce on a case-by-case basis. The Agency will make servicing decisions in such cases on the basis of best interest to the Federal Government and tenants. The Agency will bring a legal action to establish the legal capacity of the borrower to administer the project if found necessary to protect the government's interests. In order for the Agency to make servicing decisions in such cases, the borrower or the borrower's representative will provide to the Agency:

(1) On the part of the heirs or executor of the borrower's estate, evidence of legal action due to a will or court actions that establish who is to become the owner;

(2) The financial status of the borrower and any member pledging additional security for the debt;

(3) The status of the security property; and

(4) The impact of the identified actions on the operation of the project.

(b) Membership liability agreements. If a borrower's note is endorsed by individuals other than the borrower or a borrower has security agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of default, or has individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan, the security and liability agreements must be adequate to protect the Agency's interest.

(c) Security issues in participation loans. When a multi-family housing (MFH) project is receiving financing or a subsidy from sources other than the Agency, the Agency will service the account in accordance with the participation agreements made with the Agency and the other funding sources under §3560.65.

§3560.460 Double damages.

(a) Action to recover assets or income.

(1) The Agency may request to the Attorney General to bring an action in a United States district court to recover any assets or income used by any person in violation of the provisions of a loan made by the Agency under this section or in violation of any applicable statute or regulation.

(2) For the purposes of this section, a use of assets or income in violation of the applicable loan, statute, or regulation includes any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project or for which the documentation has not been maintained in accordance with the requirements of the Agency and in reasonable condition for proper audit.

(3) For the purposes of this section, the term “person” means:

(i) Any individual or entity that borrows funds in accordance with programs authorized by this section;

(ii) Any individual or entity holding 25 percent or more interest in any entity that the Agency funds in accordance with programs authorized by this section; and

(iii) Any officer, director, or partner of an entity that borrows funds in accordance with programs authorized by this section.

(b) Amount recoverable.

(1) In any judgment favorable to the United States entered under this section, the Attorney General may recover double the value of the assets and income of the project that the court determines to have been used in violation of the provisions of a loan made by the Agency under this section or any applicable statute or regulation, plus all costs related to the actions, including reasonable attorney and auditing fees.

(2) Notwithstanding any other provisions of law, the Agency may use amounts recovered under this section for activities authorized under this section and such funds must remain available for such use until expended.

(c) Time limitation. Notwithstanding any other provisions of law, an action under this section may be commenced at any time during the six-year period beginning on the date that the Agency discovered or should have discovered the violation of the provisions of this section or any related statutes or regulations.

(d) Continued availability of other remedies. The remedy provided in this section is in addition to and not in substitution of any other remedies available to the Agency or the United States.

§3560.461 Enforcement provisions.

(a) Equity skimming.

(1) Criminal penalty. Whoever, as an owner, agent, employee, or manager, or is otherwise in custody, control, or possession of property that is security for a loan made under this title, willfully uses, or authorizes the use, of any part of the rents, assets, proceeds, income, or other funds derived from such property, for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title or the regulations adopted pursuant to this title, must be fined under title 18, United States Code, or imprisoned not more than five years, or both.

(2) Civil sanctions. An entity or individual who as an owner, operator, employee, or manager, or who acts as an agency for a property that is security for a loan made under this title where any part of the rents, assets, proceeds, income, or other funds derived from such property are used for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title of the regulations adopted pursuant to this title, must be subject to a fine of not more than $25,000 per violation. The sanctions provided in this paragraph may be imposed in addition to any other civil sanctions or civil monetary penalties authorized by law.

(b) Civil monetary penalties.

(1) When civil monetary penalties may be imposed. The Agency may, after notice and opportunity for a hearing, impose a civil monetary penalty in accordance with this section against any individual or entity, including its owners, officers, general partners, limited partners, or employees, who knowingly and materially violate, or participate in the violation of, the provisions of this title, the regulation issued by the Agency pursuant to this title, or agreements made in accordance to this title by:

(i) Submitting information to the Agency that is false.

(ii) Providing the Agency with false certifications.

(iii) Failing to submit information requested by the Agency in a timely manner.

(iv) Failing to maintain the property subject to loans made under this title in good repair and condition, as determined by the Agency.

(v) Failing to provide management for a project that received a loan made under this title that is acceptable to the Agency.

(vi) Failing to comply with the provisions of applicable civil rights statutes and regulations.

(2) Amount. Civil penalties shall be assessed in accordance with 7 CFR part 3, subpart I. In determining the amount of a civil monetary penalty under this section, the Agency must take into consideration:

(i) The gravity of the offense;

(ii) Any history of prior offenses by the violator (including offenses occurring prior to the enactment of this section);

(iii) Any injury to tenants;

(iv) Any injury to the public;

(v) Any benefits received by the violator as a result of the violation;

(vi) Deterrence of future violations; and

(vii) Such other factors as the Agency may establish by regulation.

(3) Payment of penalties. No payment of a penalty assessed under this section may be made from funds provided under this title or from funds of a project which serve as security for a loan made under this title.

(4) Hearings under this part shall be conducted in accordance with the procedures applicable to hearings in accordance with 7 CFR part 1, subpart H.

(c) Conditions for renewal extension. The Agency may require that expiring loan or assistance agreements entered into under this title must not be renewed or extended unless the owner executes an agreement to comply with additional conditions prescribed by the Agency, or executes a new loan or assistance agreement in the form prescribed by the Agency.

§3560.462 Money laundering.

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 95, section 1956(c)(7)(D).

§3560.463 Obstruction of Federal audits.

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 73, section 1516(a).

§§3560.464-3560.499 [Reserved]

§3560.500 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart K--Management and Disposition of Real Estate Owned (REO) Properties

§3560.501 General.

This subpart contains Agency procedures and other policies related to the management and disposition of multi-family housing (MFH) projects in the Agency's inventory (Real Estate Owned (REO) property). Housing projects will not be accepted into the Agency's inventory unless one of the following has occurred:

(a) The borrower has abandoned the housing project and the Agency has performed the required steps to take the housing project into custody.

(b) The housing project title has been transferred to the Agency as a result of foreclosure, voluntary conveyance, redemption, or other action.

§3560.502 Tenant notifications and assistance.

Each tenant in an REO property designated to be sold as a non-program property will be notified by the Agency, in writing, of the housing projects' non-program designation and will be given an opportunity to obtain a Letter Of Priority Entitlement (LOPE) as specified in §3560.159(c).

§3560.503 Disposition of REO property.

(a) Preference will be given to offers from bidders who are determined eligible by the Agency to purchase REO property designated to be sold as program property. It is the Agency's priority that property previously operated as program property prior to becoming REO inventory property be sold as program property. However, REO property may be sold under whatever Agency program is most appropriate for the property and the community needs regardless of the program under which the property was originally financed or whether the property was being used to secure loans under more than one Agency program.

(b) When the Agency determines that the REO property to be sold is not decent, safe, and sanitary and/or does not meet cost effective energy conservation standards, it will disclose the basis for this determination to prospective purchasers. The deed by which such an REO property is conveyed will contain a covenant restricting it from residential use until it is decent, safe, and sanitary, and meets the Agency's cost effective conservation standards. The Agency will also notify any potential purchaser of any known lead based paint hazards.

§3560.504 Sales price and bidding process.

(a) The loan documents related to REO property sold for program purposes must contain the restrictive-use language specified in §3560.662(a).

(b) Entities bidding on REO property designated to be sold as program property must submit a loan application package that meets the requirements specified in subpart B of this part.

(1) Bidders on REO property designated to be sold as program property must meet the eligibility requirements established under §3560.55.

(2) Bidders determined by the Agency to be ineligible to purchase REO property designated to be sold as program property will be notified in writing. The bidding process will continue regardless of pending appeals.

(3) All offers from bidders determined to be eligible to purchase REO property designated to be sold as program property will be considered in the bidding process and must provide evidence of financial stability and credit worthiness.

(c) The Agency will determine the successful bidder on REO property designated to be sold as program property by conducting a drawing of sealed bids.

(1) The Agency may authorize the sale of an REO property by sealed bid or public auction when it is in the best interest of the Government. The Agency will publicly solicit requests for sealed bids and publicize auctions. If the highest bid is lower than the minimum acceptable bid established by the Agency, or if no acceptable bids are received, the Agency may negotiate a sale without further public notice.

(2) Bidders who desire to withdraw their bids must do so prior to the drawing date.

(d) Property designated to be sold as non-program property may be sold to entities that do not meet the Agency's eligible borrower requirements specified in §3560.55, and must be sold for cash or on terms approved by the Agency. Cash sales will be given first preference and will be drawn before any sales on terms.

§3560.505 Agency loans to finance purchases of REO properties.

(a) Agency loans to finance the purchase of REO property designated to be sold as program property must meet the same requirements as specified in subparts A and B of this part. In addition, the following provisions apply.

(1) At the borrower's option, the interest rate will be the prevailing rate at the time of loan approval or the prevailing rate at loan closing.

(2) Purchasers may pay closing costs from their own funds or, if allowable under subparts B, L, or M of this part, as applicable, may finance such costs as part of the Agency loan.

(b) Agency loans to finance the purchase of REO property designated to be sold as non-program property must meet the following terms.

(1) A down payment of not less than 10 percent of the purchase price is required at closing.

(2) The interest rate will equal the lesser of the prevailing interest rate at the time of loan approval or loan closing for MFH loans plus one-half percent.

(3) The note amount will be amortized over a period not to exceed 10 years. If the Agency determines that more favorable terms are necessary to facilitate the sale, the note amount may be amortized using a 30-year factor with payment in full due no later than 10 years from the date of closing (balloon payment). In no case will the term be longer than the useful life of the property.

(4) Agency loans to finance the purchase of non-program REO property are subject to the availability of funds.

(c) Loan limits and allowable uses of loan funds specified in subparts B, L, and M of this part, as applicable, are applicable to any Agency-financed (credit) sale of REO property.

(d) Title clearance and loan closing for an Agency financed sale and any subsequent loan to be closed simultaneously with the sale must meet the requirements in subpart B of this part for an initial loan, with the following exceptions:

(1) A “Quit Claim” or other non-warranty deed will be used; and

(2) The buyer must pay attorney's fees, insurance costs, recording fees and other customary fees unless they are included in a subsequent loan and the subsequent loan is for purposes other than closing costs and fees.

(e) After approval of an Agency-financed sale of occupied REO property designated to be sold as program property, but prior to closing, the purchaser must prepare a budget for housing operations in accordance with subpart B of this part. If a rent increase is necessary, procedures specified in subparts E and F of this part for calculating rents, net tenant contributions, and rental assistance will be followed by the borrower.

§3560.506 Conversion of single family type REO property to MFH use.

Single family type REO property may be sold for conversion to MFH program use under the following conditions:

(a) The Agency will allow nonprofit organizations, public bodies, or for-profit entities to purchase single family type REO property for conversion to MFH program use. When the Agency finances the sale of single family-type REO property for conversion to rural rental housing program use (i.e., MFH including group homes and homes for the elderly or disabled, farm labor housing, or rural cooperative housing), the sale price will be the lesser of the Federal Government's investment or an amount based on the “as-is” market value of the housing project as determined by an appraisal conducted in accordance with subpart P of this part.

(b) The Agency will only accept written offers to purchase two or more single family type REO properties for conversion to rural rental housing from nonprofit organizations, public bodies, or for-profit entities with a good record of providing housing under the Agency's MFH programs. The single family type properties are not required to be contiguous, however, they must be located in close enough proximity so that management capabilities are not diminished because of distance.

§§3560.507-3560.549 [Reserved]

§3560.550 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart L--Off-Farm Labor Housing

§3560.551 General.

This subpart establishes the requirements for making loans and grants for off-farm labor housing and for ongoing operations of this housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to the requirements in this subpart.

§3560.552 Program objectives.

(a) In addition to the objectives stated in §3560.52, off-farm labor housing loan and grant funds will be used to increase:

(1) The supply of affordable housing for farm labor; and

(2) The ability of communities to attract farm labor by providing housing which is affordable, decent, safe and sanitary.

(b) Under section 516(i) of the Housing Act of 1949 (42 U.S.C. 1486(i)), the Agency may award technical assistance grants to encourage the development of farm labor housing.

§3560.553 Loan and grant purposes.

(a) In addition to the purposes stated in §3560.53, off-farm labor housing loan and grant funds may be used to provide facilities for seasonal or temporary residential use with appropriate furnishings and equipment. A temporary residence is a dwelling which is used for occupancy, usually for a short period of time, but is not the legal domicile for the occupant.

(b) The Agency may award technical assistance grants to eligible private and public nonprofit agencies. These grant recipients will, in turn, assist other organizations to obtain loans and grants for the construction of farm labor housing.

(c) Technical assistance services may not be used to reimburse a nonprofit or public body applicant for technical services provided by a nonprofit organization, with housing and/or community development experience, to assist the nonprofit applicant entity in the development and packaging of its loan/grant docket and project. In addition, technical assistance will not be funded by the Agency when an identity of interest exists between the technical assistance provider and the loan or grant applicant.

§3560.554 Use of funds restrictions.

Off-farm labor housing loan and grant funds may not be used for any purpose prohibited by §3560.54 except §3560.54(a)(1). Off-farm labor housing may be used to serve migrant farmworkers.

§3560.555 Eligibility requirements for off-farm labor housing loans and grants.

(a) Eligibility for loans. Applicants for off-farm labor housing loans must be:

(1) A broad-based nonprofit organization, a nonprofit organization of farmworkers, a federally recognized Indian tribe, a community organization, or an agency or political subdivision of State or local government, and must meet the requirements of §3560.55, excluding §3560.55(a)(6). A broad-based nonprofit organization is a nonprofit organization that has a membership that reflects a variety of interests in the area where the housing will be located; or

(2) A limited partnership with a non-profit general partner which meets the requirements of §3560.55(d).

(b) Eligibility for grants. To be eligible for off-farm labor housing grants, applicants must:

(1) Meet the requirements in §3560.555(a)(1); and

(2) Be able to contribute at least one-tenth of the total farm labor housing development cost from its own or other resources. The applicant's contribution must be available at the time of grant closing. An off-farm labor housing loan financed by RHS may be used to meet this requirement.

(c) Limitation. Limited partnerships eligible under paragraph (a)(2) of this section are not eligible for farm labor housing grants.

§3560.556 Application requirements and processing.

Off-farm loans and grants will be available under a Notice of Funding Availability (NOFA) that will be published in the Federal Register each fiscal year.

§3560.557 [Reserved]

§3560.558 Site requirements.

The requirements established in §3560.58 apply to all applications for off-farm labor housing loans and grants except that off-farm labor housing are not limited to rural areas.

§3560.559 Design and construction requirements.

(a) General. The requirements established in §3560.60 apply to all applications for off-farm labor housing loans and grants except that seasonal off-farm labor housing that will be occupied for eight months or less per year by migrant farmworkers while they are away from their residence, may be constructed in accordance with Exhibit I of 7 CFR part 1924, subpart A.

(b) Additional requirements. In addition to the requirements established in §3560.60, it is encouraged that the design of off-farm labor housing incorporate outdoor shower, boot washing station, and/or hose bibb facilities as necessary to protect the resident and the asset from excess dirt and chemical exposure.

(c) Davis-Bacon wage requirements. Construction financed with the assistance of a Section 516 grant will be subject to the provisions of the Davis-Bacon Act (40 U.S.C. 276(a)-276(a)(7)), and the implementing regulations published by the Department of Labor at 29 CFR parts 1, 3, and 5.

§3560.560 Security.

The security requirements established in §3560.61 will apply to all applications for off-farm labor housing loans.

§3560.561 Technical, legal, insurance and other services.

The requirements established under §3560.62 apply to all applications for off-farm labor housing loans and grants.

§3560.562 Loan and grant limits.

(a) Determining the security value. The requirements established under §3560.63(a) apply to off-farm labor housing loans.

(b) Maximum amount of loan. The requirements established in §3560.63(c)(1) and (2), regarding borrower equity contribution apply to all applications for off-farm labor housing loans. (For applicants eligible under §3560.555(a)(2), the amount of Agency financing for the housing will not exceed 95 percent of the total development cost or 95 percent of the security value available for the Agency loan, whichever is lower.) In determining the amount of the loan, the Agency will also review the capacity of the applicant to amortize such loan, considering any rental assistance provided for use in the housing, and any rents anticipated to be paid by farmworkers expected to occupy the housing.

(c) Maximum amount of grant. The amount of any off-farm labor housing grant must not exceed the lesser of:

(1) Ninety percent of the total development cost, or

(2) That portion of the total development cost which exceeds the sum of any amount provided by the applicant from their own resources plus the amount of any loans approved for the applicant, considering the capacity of the applicant to amortize the loan.

§3560.563 Initial operating capital.

The requirements for §3560.64 apply to all applications for off-farm labor housing loans and grants.

§3560.564 Reserve accounts.

The requirements for §3560.65 apply to all applications for off-farm labor housing loans and grants.

§3560.565 Participation with other funding or financing sources.

The requirements established in §3560.66 apply to all applications for off-farm labor housing loans and grants, except that the 25 percent requirements stated in paragraph §3560.66(b)(1) may consist of loan and/or grant funds.

§3560.566 Loan and grant rates and terms.

(a) Amortization period. The loan will be amortized over a period not to exceed 33 years. The amortization schedule will take into account the depreciation of the security and ensure that the loan will be adequately secured.

(b) Interest rate. The effective interest rate will be 1 percent.

(c) Term of grant agreement. The grant agreement will remain in effect for so long as there is a need for farm labor housing..

§3560.567 Establishing the profit base on initial investment.

The requirements established under §3560.68 apply to applicants eligible under §3560.555(a)(2) and operating as a limited partnership with a nonprofit general partner.

§3560.568 Supplemental requirements for seasonal off-farm labor housing.

For off-farm labor housing operating on a seasonal basis, the management plan must establish specific opening and closing dates. During the off-season, off-farm labor housing may be used as defined in subpart A of this part under short-term lease provisions. Where rents are charged on a per-unit basis and family income qualifies the household for rental assistance, rental assistance may be used.

§3560.569 Supplemental requirements for manufactured housing.

The requirements established in §3560.70 apply to all applications for off-farm labor housing loans and grants.

§3560.570 Construction financing.

The requirements established in §3560.71 apply to all applications involving off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) Equity contributions being made by a borrower or grantee must be contributed and disbursed prior to any disbursement of interim loan funds and any loan or grant funds from the Agency.

(b) If the Agency is providing both loan and grant funds, loan funds must be fully released and expended prior to the release of grant funds by the Agency.

(c) If construction is financed with a Labor Housing grant, it is subject to the provisions of the Davis-Bacon Act (published in the Department of Labor regulations 29 CFR parts 1, 2, and 5).

§3560.571 Loan and grant closing.

The requirements established in §3560.72 apply to all applications for off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) A nonprofit organization will have its Board of Directors adopt an Agency-approved loan and/or grant resolution, which is required as part of the loan docket before loan and/or grant approval. All other loan applicants will execute an Agency-approved loan agreement.

(b) For grants, an Agency approved grant agreement, must be executed by the applicant on the date of grant closing.

(c) The obligations incurred by the applicant, as a condition of accepting the grant, will be in accordance with the off-farm labor housing grant agreement.

(d) Off-farm labor housing loans used to build or acquire new units made pursuant to a contract entered into on or after the effective date of this regulation, will be subject to the restrictive-use provision stated in §3560.72(a)(2)(ii). All other off-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation. Such restrictions must be included in the mortgage and deed of trust.

§3560.572 Subsequent loans.

The requirements established in §3560.73 will apply to all applications for subsequent off-farm labor housing loans.

§3560.573 Rental assistance.

(a) Rental assistance may be provided to income eligible tenants living in off-farm labor housing in accordance with subpart F of this part. The requirements established in §3560.252 apply to all tenants receiving rental assistance.

(b) For dormitory style facilities operating on a per bed basis, rental assistance will be made available to the housing on a per unit basis, but may be pro-rated to tenants on a per bed basis. However, total rent charged for a unit must not exceed conventional rent for comparable units in the area or a similar area and per bed rents must be comparable to per bed rents in the market.

§3560.574 Operating assistance.

Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under section 514 or section 516(i) of the Housing Act of 1949 (U.S.C. 1486(i)) that serve migrant farmworkers. Owners of eligible projects may choose tenant-specific rental assistance as described in §3560.573 or operating assistance, or a combination of both, however, any tenant or unit assisted under this section may not receive rental assistance under §3560.572. The objective of this program is to provide assistance toward the cost of operating the project so that rents may be set at rates that are affordable to very low and low-income migrant farmworkers.

(a) Project eligibility requirements. To be eligible for the operating assistance program, projects must be:

(1) Off-farm labor housing projects financed under section 514 or section 516 with units that are for migrant farmworkers. Housing units for year-round farmworker households are ineligible; and

(2) Eligible for the Agency's rental assistance program as defined in §3560.573.

(b) Operating assistance limits. The amount of operating assistance requested by the owner must be based on the project's actual income and expenses and must be approved by the Agency. In the case of a mixed project, the amount of operating assistance must be based on the portion of actual income and expenses that are attributable to the units that are for migrant farmworkers. In no instance may the annual amount of operating assistance exceed 90 percent of the annual operating costs that are attributable to the migrant units.

(c) Owner responsibilities.

(1) Requesting for operating assistance program. Owners of off-farm labor housing projects with units for migrant farmworkers may request operating assistance by submitting a request to the Agency, which must include a budget. The budget must include:

(i) Estimated operating costs for the migrant units, including authorized expenditures such as reserve deposits;

(ii) Proposed rental rates for the migrant units to generate sufficient funds for operating costs of those units, taking into consideration all other sources of project income; and

(iii) Estimated rental income from tenants, based on a tenant contribution of 30 percent of the average adjusted monthly income of migrant farmworker households in the area.

(2) Requesting operating assistance payments. Each month, the owner will submit a request for operating assistance to the Agency.

(3) Verifying tenant income eligibility. Owners are responsible for verifying tenant income eligibility. Only very low or low-income households are eligible for the operating assistance rents. Households with incomes above the low-income limits must pay the full rent.

(4) Reporting requirements.

(i) Owners will complete and submit to the Agency tenant certifications to document tenant income and eligibility.

(ii) Owners will complete and submit monthly to the Agency a project worksheet for operating assistance.

(iii) Owners must submit an annual planning budget to the Agency prior to the project's fiscal year.

§3560.575 Rental structure and changes.

Off-farm labor housing is subject to the tenant contribution and rental unit rent requirements for Plan II housing established under subpart E of this part, except where seasonal housing will be occupied for less than a 3-month period. In such instances the best available and practical income verification methods may be used with prior approval of the Agency.

§3560.576 Occupancy restrictions.

(a) Restrictions on conditions of occupancy.

(1) No borrower or grantee will be permitted to require that an occupant work on any particular farm or for any particular owner or interest as a condition of occupancy of the housing.

(2) Tenant selection should be in accordance with the loan agreement, subpart D of this part and §3560.577.

(3) No borrower or grantee will discriminate, or permit discrimination by any agent, lessee, or other operator in the use or occupancy of the housing or related facilities because of race, color, religion, sex, age, disability, familial status, or national origin.

(b) Eligible households. To be eligible for occupancy in off-farm labor housing, households must meet the following requirements.

(1) Occupational. An eligible household must include a domestic tenant or co-tenant farm laborer, a retired domestic farm laborer, or a disabled domestic farm laborer.

(2) Income. The household must meet the definition of income eligible as established in §3560.152 and the tenant or co-tenant must receive a substantial portion of income from farm labor employment. To determine if a substantial portion of income is from farm labor employment, the following measures will be used.

(i) For housing rented to farm laborers and owned by public bodies, public or private nonprofit organizations, and limited partnerships when charging rent.

(A) Actual dollars earned from farm labor by domestic farm laborers other than migrant farmworkers must equal at least 65 percent of the annual income limits indicated for the Standard Federal regions as published by the Agency for their particular region of the country. For migrant farmworkers living in seasonal housing the actual dollars earned from farm labor by a domestic farm laborer must equal at least 50 percent of annual income limits indicated for the Standard Federal regions, as published by the Agency.

(B) An alternate measure for determining substantial portion of income when actual earnings are not available may be the duration of time a farm laborer worked on a farm or other farming enterprise as a domestic farmworker during the preceding 12 months. In order to be considered as substantial the farm laborer

must have worked at least 110 whole days in farm work. For purposes of this section one whole day is the equivalent of at least 7 hours. When using a period of more than 1 year, a yearly average must amount to at least 110 days per year.

(ii) For housing owned by a farmer, family-farm partnership, family-farm corporation, or an association of farmers which was initially provided on a non-rental basis, a substantial portion of
income is earned when housing is provided by the owner as part of employment compensation for farm labor.

(iii) When a natural disaster has occurred, such as a drought, flood, freeze, etc., figures for the 12 months preceding such disaster will be used to determine substantial portion of income under paragraph (b)(2) of this section.

(iv) The tenant who qualifies as a domestic farm laborer residing in a property with a nonrestrictive farm labor clause in the mortgage covenants must not have adjusted income which exceeds the moderate income limit for the appropriate household size and appropriate geographical area.

(3) Occupancy. The household must remain in compliance with the borrower's occupancy policy as established in §3560.155.

(c) Tenant eligibility requirements for operating assistance rents. To be eligible for operating assistance rents, tenants must meet the rental assistance eligibility requirements described in §3560.573 and in §3560.252.

(d) Ineligible tenants. Tenants who, at any time, fail to meet all the requirements in paragraph (b) of this section will be deemed ineligible for occupancy in off-farm labor housing. Ineligible tenants in off-farm labor housing will be addressed in accordance with the requirements of §3560.158.

(e) Non-farm laborer tenants. When there is a diminished need for housing for persons or families in the above categories, units in off-farm labor housing complexes may be made available to persons or families eligible for occupancy under §3560.152. Eligible tenants under this section may occupy the labor housing until such time the units are again needed by persons or families eligible under paragraph (b) of this section. As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence. The procedures specified in §3560.158 shall be followed when tenants are required to vacate housing to allow for occupancy by persons eligible under paragraph (b) of this section.

§3560.577 Tenant priorities for labor housing.

Tenant occupancy in off-farm labor housing is based on eligible farm labor certified through the income certification process required by §3560.152 and is prioritized in the following order.

(a) First priority is to be given to eligible active farm laborer households with first priority going to very low-income households, next priority to low-income households, and last to moderate-income households.

(b) Second priority is given to retired domestic farm laborer households and disabled domestic farm laborer households who were active in the local farm labor market area at the time of retiring or becoming disabled. Occupancy priority will be given in accordance with paragraph (a) of this section.

(c) Third priority is to be given to retired domestic farm laborer households and disabled domestic farm laborer households who were not active in the local farm labor market at the time of retiring or becoming disabled. Occupancy priority will be given in accordance with paragraph (a) of this section.

§3560.578 Financial management of labor housing.

The requirements established in subpart G of this part will apply to all off-farm labor housing.

§3560.579 Servicing off-farm labor housing.

The requirements established in subparts I and J of this part will apply to all off-farm labor housing. Servicing according to subparts I and J of this part shall apply throughout the term of the loan or grant, whichever is longer.

§§3560.580-3560.599 [Reserved]

§3560.600 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart M--On-Farm Labor Housing

§3560.601 General.

This subpart contains the requirements for making loans for on-farm labor housing and for ongoing operation and management of on-farm labor housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to requirements given in this subpart.

§3560.602 Program objectives.

In addition to the objectives stated in §3560.52, on-farm labor housing funds will be used to increase:

(a) The supply of affordable housing for farm labor; and

(b) The ability of the farmer to provide affordable, decent, safe and sanitary housing for farm workers.

§3560.603 Loan purposes.

On-farm labor housing loans may be made only for the purposes established in §3560.553. Grants are not available for on-farm labor housing.

§3560.604 Restrictions on use of funds.

On-farm labor housing loans may not be used for any purpose prohibited by §3560.54 except §3560.54(a)(1). On-farm labor housing may be used to serve migrant workers. In addition, on-farm labor housing loan funds may not be used to provide housing for members of the immediate family of the applicant when the applicant is an individual farm owner, family farm corporation, family farm partnership, or a member of an association of farmers. Immediate family includes mother, father, brothers, sisters, sons, and daughters of the applicant and spouse.

§3560.605 Eligibility requirements.

(a) To be eligible for an on-farm labor housing loan, the applicant must meet the requirements of §3560.55(a) with the exception of §3560.55(a)(1), (5), and (6) and the following requirements.

(1) The applicant must be a farm owner, family farm partnership, family farm corporation, or an association of farmers engaged in agricultural or aquacultural farming operations whose farming operations demonstrate a need for on-farm labor housing and who will own the housing and operate it on a nonprofit basis.

(2) The applicant must agree to use the labor housing to engage in the farming operations of the individual farm owner applicant, or in the farming operations of its members if it is a family farm corporation or partnership, or an association of farmers.

(3) The applicant must, as determined by the Agency, be unable to provide the necessary housing from the applicant's own resources and be unable to obtain credit from any other source upon terms and conditions which the applicant could reasonably be expected to fulfill. If the applicant is an association of farmers or family farm corporation or partnership, the individual members, individually and jointly, must be unable to provide the necessary housing by utilizing their own resources and be unable, by pledging their personal liability, to obtain other credit that would enable them to provide housing for farm workers at rental rates they can afford to pay. The individual resources of family farm corporation or partnership members with less than a 10 percent corporate or partnership interest should not be considered when determining if the applicant can obtain credit elsewhere.

(b) The Agency may make an exception to the requirement that an individual farm owner, family farm corporation, family farm partnership or an association of farmers be unable to obtain the necessary credit elsewhere when all of the following conditions exist:

(1) There is a housing need in the area for domestic farmworkers who are migrants and the applicant will provide such housing; and

(2) There are no qualified state or political subdivisions or public or private nonprofit organizations available, or likely to become available within 12 months of the application, that are willing and able to provide the housing.

(c) When an applicant is determined eligible under paragraph (b) of this section, the interest rate for such loans will be determined in accordance with 7 CFR part 1810, subpart A.

(d) On-farm labor housing that consists of buildings with less than three units is not subject to the requirement that five percent of the units be constructed as fully accessible units, as described in §3560.60(d).

§3560.606 Application requirements and processing.

(a) On-farm labor housing loan applications will be processed according to 7 CFR part 1940, subpart L. Applicants must submit an application in an Agency-approved format that adequately documents the need for the housing and the eligibility of the applicant.

(b) The applicant must certify that the farm workers for which the housing is intended are or will be involved in the applicant's agricultural or aquacultural farming operations.

(c) The applicant must certify that housing operations will be conducted in a non-profit manner such that income from the housing does not exceed eligible expenses associated with the housing. Eligible expenditures for the housing include, but are not limited to housing repairs and upkeep, payment of installments on the loan, taxes, insurance and reserves and other essential uses needed for success of the operations.

§3560.607 [Reserved]

§3560.608 Site and construction requirements.

(a) General. Cost and development standards for on-farm labor housing will be consistent with the requirements, standards, and cost limits specified in subpart B of this part, if the housing is a multi-family housing type structure, or consistent with section 502 of the Housing Act of 1949, if the housing is a single family type structure.

(b) Permanent units. On-farm labor housing occupied for 8 months or more of the year will be required to meet the following requirements.

(1) Housing may be multi-family or single family in type and may be located on the farm away from farm service buildings, or in the nearby community. Single-family type housing is defined as an individual or a group of individual single family detached dwelling units. All sites and housing shall be planned and constructed in accordance with 7 CFR part 1924, subparts A and C.

(2) Sites must be accessible from a public road, when feasible.

(c) Seasonal units. On-farm labor housing occupied for less than 8 months of the year will be considered seasonal housing. Such housing must meet the following requirements.

(1) Housing designed for seasonal occupancy may be either single family or multi-family.

(2) Seasonal housing may be constructed in accordance with exhibit I of 7 CFR part 1924, subpart A. If constructed in accordance with exhibit I, the housing must be suitable to allow for conversion to full-year occupancy if the need for migrant farmworkers in the area declines.

(d) Accessibility. On-farm labor housing that consists of buildings with less than three units, need not meet the requirement that five percent of the units be constructed as fully accessible units, as described in §3560.60(d). This does not, however, eliminate any other accessibility requirements.

§3560.609 [Reserved]

§3560.610 Security.

(a) Security instruments must meet the requirements established under §3560.560.

(b) When feasible, the on-farm labor housing will be located on a tract of land that is surveyed such that, for security purposes, it is considered separate and distinct from the farm. The security for the loan must include a lien on the tract of land where the on-farm labor housing is located and the security must have adequate value to protect the Federal government's interest. The Agency will seek a first or parity lien position on Agency-financed property in all instances, however, the Agency may accept a junior lien position if the Federal government's interests are adequately secured.

(c) The Agency will determine the value of the security for the loan in accordance with 7 CFR part 1922, subpart B if the farm is used as security or in accordance with section 502 of the Housing Act of 1949, if only the on-farm labor housing and related land is used for security.

(d) If necessary to provide adequate security for the loan, the Agency may require that any household furnishings purchased with loan funds also be secured.

(e) Personal liability and recourse will be required of all borrowers, including the individual members, stockholders or partners of an association of farmers, family farm corporations or partnerships, respectively.

§3560.611 Technical, legal, insurance and other services.

When technical, legal, insurance, or services are required for development of on-farm labor housing, applicants must comply with the applicable requirements of §3560.62. Regarding insurance coverage, the requirements of §3560.62(d) apply to on-farm labor housing.

§3560.612 Loan limits.

The maximum loan amount will be 100 percent of the allowable total development costs of on-farm labor housing and related facilities subject to §§3560.603, 3560.604 and 3560.608.

§3560.613 [Reserved]

§3560.614 Reserve accounts.

When on-farm labor housing operations include 12 or more units, the Agency will require such properties to comply with the reserve account requirements in §3560.65.

§3560.615 Participation with other funding sources.

The Agency encourages the use of other funding sources in conjunction with on-farm labor housing loans. Use of such financing in conjunction with an on-farm labor housing loan is subject to the approval of the Agency and must comply with the requirements of §3560.66.

§3560.616 Rates and terms.

(a) The interest rate for on-farm labor housing loans will be 1 percent.

(b) The term of the on-farm labor housing loan will not exceed 33 years.

(c) Loan amortization for on-farm labor housing may be on a monthly or an annual basis.

§3560.617 [Reserved]

§3560.618 Supplemental requirements for on-farm labor housing.

The management plan for on-farm labor housing operated on a seasonal basis must have specific opening and closing dates. During the off-season, on-farm labor housing may be used under short-term lease provisions.

§3560.619 Supplemental requirements for manufactured housing.

On-farm labor housing loan funds used for manufactured housing must comply with §3560.70. Manufactured housing located on-farm may consist of individual units.

§3560.620 Construction financing.

The requirements established in §3560.71 apply to all applications involving on-farm labor housing loans.

§3560.621 Loan closing.

Applicants for on-farm labor housing loans must execute an Agency-approved loan agreement. In addition, if determined appropriate by the Agency, on-farm labor housing loans made on or after the effective date of this regulation may be subject to the restrictive-use provisions as stated in §3560.72(a)(2)(ii). All other on-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation.

§3560.622 Subsequent loans.

The requirements established in §3560.572 apply to all applications for on-farm labor housing subsequent loans.

§3560.623 Housing management and operations.

Borrowers with on-farm labor housing loans must:

(a) Develop and submit to the Agency a management plan in a format specified by the Agency. At a minimum, the management plan will detail the borrower's operational and occupancy policies, how the borrower will deal with resident complaints, and how repairs will be completed; and

(b) Maintain a lease or employment contract with each tenant specifying employment with the borrower as a condition for continued occupancy.

§3560.624 Occupancy restrictions.

(a) The immediate relatives of the borrowers are ineligible occupants for on-farm labor housing.

(b) Occupants must meet the definition of a domestic farm laborer, as defined in §3560.11.

(c) Occupancy of on-farm labor housing is restricted to employees of the borrower unless otherwise approved by the Agency.

(d) With prior written permission of the Agency, on-farm labor housing may be occupied by ineligible tenants on a short-term basis. The permission of the Agency must also be for a limited duration.

§3560.625 Maintaining the physical asset.

On-farm labor housing must meet state and local building and occupancy codes.

§3560.626 Affirmative Fair Housing Marketing Plan.

On-farm labor housing must meet the requirements of §3560.104.

§3560.627 Response to resident complaints.

The management plan submitted in accordance with §3560.623 (a) will include a provision for dealing with resident complaints.

§3560.628 Establishing and modifying rental charges.

If it becomes necessary to establish or modify a shelter cost, the borrower must obtain Agency approval as specified in subpart E of this part.

§3560.629 Security deposits.

Borrowers that require security deposits to be paid by the tenants will be required to comply with the requirements of §3560.204.

§3560.630 Financial management.

Financial information must be submitted in an Agency-approved format and will show operation of the housing in a nonprofit manner.

§3560.631 Agency monitoring.

A compliance review and physical inspection will be conducted by the Agency at least once every 3 years. The purpose of this review will be to inspect:

(a) Tenant eligibility documentation;

(b) Financial information on the operation and management of the labor housing, including relevant borrower financial materials;

(c) Payment of taxes, insurance and hazard insurance;

(d) Compliance with the security deposit requirements;

(e) Compliance with the operating plan;

(f) Compliance with the loan agreement;

(g) Compliance with Agency requirements for affordable, decent, safe, and sanitary housing; and

(h) Compliance with civil rights requirements.

§3560.632-3560.649 [Reserved]

§3560.650 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart N--Housing Preservation

§3560.651 General.

(a) This subpart contains the Agency's housing preservation requirements as related to prepayment requests and restrictive-use provisions (RUPs). The requirements of this subpart support the Agency's commitment to the preservation of decent, safe, sanitary, and affordable multi-family housing (MFH) for very low-, low-, and moderate-income households.

(b) The Agency will coordinate, direct, and monitor the Agency's MFH preservation activities from the National Office level.

§3560.652 Prepayment and restrictive-use categories.

(a) Loans with prepayment prohibitions include:

(1) Initial Section 515 loans made on or after December 15, 1989, and

(2) Subsequent loans made on or after December 15, 1989, for additional rental units.

(b) Loans without prepayment prohibitions but with restrictive-use provisions include:

(1) All loans made after December 21, 1979, but prior to December 15, 1989;

(2) Subsequent loans made on or after December 15, 1989, for purposes other than additional rental units; or

(3) Loans subsequently restricted by servicing actions including transfers.

(c) Loans without prepayment prohibitions or restrictive-use provisions include all loans made on or before December 21, 1979, or loans that had restrictive-use provisions that have expired. Such loans are eligible to receive incentives subject to the provisions of this subpart.

(d) Loans may be prepaid if another loan or grant from the Agency imposes the same or more stringent restrictive-use provisions on the housing project covered by the loan being prepaid.

(e) Third-party subsidy (e.g., Section 8) will not be used as a substitute for RUPs.

§3560.653 Prepayment requests.

(a) Borrowers seeking to prepay an Agency loan must submit a written prepayment request to the Agency at least 180 days in advance of the anticipated prepayment date and must obtain Agency approval before the Agency will accept prepayment.

(b) Prior to submitting a prepayment request, borrowers must take whatever actions are necessary to provide the following items:

(1) A clear description of the loan to be prepaid, the housing project covered by the loan being prepaid, and the requested date of prepayment.

(2) A statement documenting the borrower's ability to prepay under the terms specified.

(3) A certification that the borrower will comply with any Federal, State, or local laws or regulations which may relate to the prepayment request and a statement of actions needed to assure such compliance.

(4) A copy of lease language to be used during the period between the submission date and the final resolution of the prepayment request notifying tenant applicants that the owner of the housing project has submitted a prepayment request to the Agency and explaining the potential affect of the request on the lease.

(5) Borrowers are required to submit a signed release of information form along with the prepayment request. The Agency will notify nonprofit organizations and public bodies involved in providing affordable housing or financial assistance to tenants of the receipt of a borrower's request to prepay their MFH loan(s). Additionally, the Agency is to notify nonprofit organizations and public bodies whenever a borrower, who has requested prepayment, is required or elects to offer their property for sale to a nonprofit or public body.

(6) A certification that the borrower has notified all governmental entities involved in providing affordable housing or financial assistance to tenants in the project has provided a statement specifying how long financial assistance from such parties will be provided to tenants after prepayment.

(7) A statement affirming that units in the property applying for prepayment will continue to be available for rent by eligible residents during the prepayment process.

(c) The Agency will review complete requests to determine if:

(1) The loan is eligible for prepayment under §3560.652(b);

(2) The borrower has the ability to prepay; and

(3) The borrower has complied or has the ability to comply with applicable Federal, State, and local laws related to the prepayment request.

(d) If a prepayment request lacks full and complete information on any item, the Agency will return the prepayment request to the borrower with a letter citing the deficiencies in the prepayment request. The Agency will offer borrowers an opportunity, within 30 days following the date of the return, to address the reasons given by the Agency for the return of the prepayment request and will allow the borrower to submit a revised prepayment request appropriately satisfies all the conditions listed in paragraph (d) of this section, the Agency will process the prepayment request and make a reasonable effort to enter into a new restrictive-use agreement with the borrower in accordance with §3560.662 or §3560.655. If the Agency determines that a loan is ineligible for prepayment or the borrower does not have the ability to prepay, the Agency will return the prepayment request to the borrower with a written explanation of the Agency's determinations.

§3560.654 Tenant notification requirements.

(a) Within 30 calendar days of receiving a complete prepayment request, the Agency will send a prepayment request notice to each tenant in the housing project. Borrowers must post the Agency's prepayment request notice in public areas throughout the housing

project from the date of the notice until the final resolution of the prepayment request. The prepayment request notice will establish a date and place where tenants may meet with the Agency to discuss the prepayment request and will advise tenants that:

(1) They may review all information submitted with the prepayment request except financial information regarding the borrower entity, which the Agency will withhold from tenant review unless given written permission for the release of the information from the borrower; and,

(2) They have 30 days from the date of the prepayment request notice to give the Agency comments on the prepayment request.

(b) Borrowers may provide a prepayment request notice of their own directly to tenants and may establish a date and place where tenants may meet with the borrower to discuss the prepayment request. The Agency and other providers of housing assistance for very-low, low, and moderate-income households may attend a borrower's prepayment request meeting with tenants.

(c) If the Agency agrees to accept prepayment on a loan, the Agency will send a prepayment acceptance notice to each tenant in the housing project at least 60 days prior to the prepayment date. Borrowers must post copies of the Agency's prepayment acceptance notice in public areas throughout the housing project until prepayment is made. If the prepayment acceptance was based on a borrower's agreement to comply with restrictive-use provisions, the notice will describe the restrictive-use provisions that will apply to the housing project after prepayment and the tenant's rights to enforcement of the provisions.

(d) If the borrower withdraws the prepayment request, the Agency will provide a prepayment request cancellation notice to each tenant in the housing project. Borrowers must post copies of the prepayment request cancellation notice in the public areas throughout the housing project for a period of 60 days following the date of the prepayment request cancellation notice.

(e) If the borrower agrees to accept incentives and restrictive-use provisions, the Agency will notify each tenant, in writing, of the agreement and provide a description of the restrictive-use provision.

(f) If a borrower agrees to sell a housing project involved in a prepayment request to a nonprofit organization or public body, the Agency will notify each tenant, in writing, of the proposed sale to a nonprofit organization or public body and will explain the timeframes involved with the proposed sale, any potential impact on tenants, and the actions tenants may take to alleviate any adverse impact. Borrowers must post copies of the Agency's proposed sale notice in public areas throughout the housing project until the housing project is sold or the offer to sell is withdrawn.

(g) If a tenant applicant signs a lease in a housing project for which a prepayment request has been submitted, the borrower must provide the tenant with copies of all notifications provided to tenants by the Agency or the borrower prior to the tenant's occupancy in the housing project.

(h) If a borrower is unable to sell a housing project involved in a prepayment request to a nonprofit organization or public body within 180 days as specified in §3560.659, the Agency will send a notice to each tenant in the housing project explaining the potential impact of the borrower's inability to sell the housing project on tenants and the actions tenants may take to alleviate any adverse impact. Borrowers must post the Agency's notice in public areas throughout the housing project for a period of 60 days following the date of the notice.

§3560.655 Agency requested extension.

Before accepting an offer to prepay from a borrower with a restricted loan, the Agency must first make a reasonable effort to enter into a new restrictive-use agreement with the borrower. Under this agreement, the borrower would make a binding commitment to extend the low-income use of the housing and related facilities for 20 years for loans with interest credit, beginning on the date on which the new agreement is executed. If the borrower is unwilling to enter into a new restrictive-use provisions and restrictive-use agreement, the Agency should proceed to take the actions described in §3560.658.

§3560.656 Incentives offers.

(a) The Agency will offer a borrower, who submits a prepayment request meeting the conditions of §3560.653(d), incentives to agree to the restrictive-use period in §3560.662 if the following conditions are met:

(1) The market value of the housing project is determined by the Agency, based on an appraisal conducted in accordance with subpart P of this part.

(2) There are no restrictive-use agreements or prepayment prohibitions in effect.

(b) Specific incentives offered will be based on the Agency's assessment of:

(1) The value of the housing project as determined by the Agency based on an "as-is" market value appraisal conducted in accordance with subpart P of this part;

(2) An incentive amount that will provide a fair return to the borrower;

(3) An incentive amount that will not cause basic rents at the housing project to exceed conventional rents for comparable units; except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150 percent of the comparable rent for conventional unit rent level; and

(4) An incentive amount that will be the least costly alternative for the Federal Government while being consistent with the Agency's commitment to the preservation of housing for very-low, low, and moderate income households in rural areas.

(c) The Agency may offer the following incentives:

(1) The Agency may increase the borrower's annual return on equity by one of the following two methods. The actual withdrawal of the return remains subject to the procedures and conditions for withdrawal specified in subpart G of this part.

(i) The Agency may recognize the borrower's current equity in the housing project. The equity will be determined using an Agency accepted appraisal based on the housing project's value as unsubsidized conventional housing.

(ii) When a current appraisal indicates an equity loan cannot be made, the Agency may recognize the borrower's current equity in the housing project at the higher of the original rate of return or the current 15-year Treasury bond rate plus 2 percent rounded to the nearest one-quarter percent. The equity will be determined using the most recent Agency accepted appraisal of the housing project prior to receiving the prepayment request.

(2) The Agency may agree to convert projects without interest credit or with Plan I interest credit to Plan II interest credit or increase the interest credit subsidy for loans with Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

(3) The Agency may offer additional rental assistance, or an increase in assistance provided under existing contracts under Section 521(a)(2), 521(a)(5) of the Housing Act of 1949 (42 U.S.C. 1490a(a)(2)) or Section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437).

(4) The Agency may make an equity loan to the borrower. The equity loan must not adversely affect the borrower's ability to repay other Agency loans held by the borrower and must be made in conformance with the following requirements:

(i) The equity loan must not exceed the difference between the current unpaid loan balance and 90 percent of the housing project's value as determined by an "as-is" market value appraisal conducted in accordance with subpart P of this part.

(ii) Borrowers with farm labor housing loans are not eligible to receive equity loans as incentives.

(iii) I f an incentive offer for an equity loan is accepted, the equity loan may be processed and closed with the borrower or any eligible transferee.
(iv) Excess reserve funds will be used to reduce the amount of an equity loan offered to a borrower.

(v) Equity loans may not be offered unless the Agency determines that other incentives are not adequate to provide a fair return on the investment of the borrower to prevent prepayment of the loan or to prevent displacement of project tenants.

(5) The Agency will offer rental assistance to protect tenants from rent overburden caused by any rent increase as a result of a borrower's acceptance of an incentive offer or tenants who are currently overburdened.

(6) In housing projects with project-based Section 8 assistance, the Agency may permit the borrower to receive rents in excess of the amounts determined necessary by the Agency to defray the cost of long-term repair or maintenance of such a project.

(d) The Agency must determine that the combination of assistance provided is necessary to provide a fair return on the investment of the borrower and is the least costly alternative for the Federal Government.

(e) At the time a specific incentive offer is developed, the Agency must take into consideration the costs of any deferred maintenance, items in the housing project's operating budget, and any expected long-term repair or replacement costs based on a capital needs assessment developed in accordance with §3560.103(c). Deferred maintenance may include specific items identified in previous Agency inspections where the borrower has had the opportunity and resources available to take corrective actions and did not.

(1) Deferred maintenance does not include routine repair and replacement that results from normal wear and tear of the physical asset. The amount required for the reserve account to be considered fully funded will be adjusted accordingly. To determine if basic rents exceed conventional rents for comparable units in the area, monthly contributions necessary to obtain the adjusted fully funded reserve account will be included in the calculation of basic rents.

(2) Deferred maintenance including any deficiencies identified in project compliance with Section 504 of the Rehabilitation Act of 1973 must be addressed as part of the development of the incentive and must be completed as part of an acceptance agreement of any incentive.

(f) Existing loans must be consolidated, provided consolidation retains the Agency's lien position, and reamortized in accordance with subparts I and J of this part, provided it maintains feasibility of the housing for the tenants or reduces the debt service or the level of monthly rental assistance.

(g) The borrower must accept or reject the incentive offer within 30 days. If no answer to the offer is received within 30 days, the Agency may consider the incentive offer to be rejected.

(1) If the borrower accepts the incentive offer, procedures outlined in §3560.657 must be followed.

(2) If the borrower rejects the incentive offer, the borrower must comply with requirements listed in §3560.658.

§3560.657 Processing and closing incentive offers.

(a) Borrower responsibilities. If a borrower accepts the Agency's offer of incentives, the borrower must complete the following actions:

(1) Subject to the Agency's approval, the borrower must legally restrict the use of the project in accordance with and for the number of years stated in §3560.662.

(2) If the incentive offer accepted includes an equity loan, the borrower must complete an application for the equity loan, and the borrower must continue to qualify as an eligible borrower or transferee in accordance with subpart B of this part.

(3) If the incentive offer accepted includes rent increases, the borrower must follow the rent increase requirements established in subpart E of this part.

(b) Waiting lists. If funds for components of incentive offers are limited, the Agency will establish a waiting list of accepted incentive offers for funding in the date order that the complete prepayment request was received.

(c) Unfunded incentive offers. If the borrower accepts the incentive offer but the Agency is unable to fund the incentive within 15 months, the borrower may choose one of the following actions:

(1) The borrower may offer to sell the housing project in accordance with §3650.659. In this case the borrower will be removed from the list of borrowers awaiting incentives.

(2) The borrower may stay on the list of borrowers awaiting incentives until the borrower's incentive offer is funded. The Agency will not negotiate the incentive offer; but, at a borrower's request, may adjust the incentive amount to reflect an updated appraisal, loan balance, and terms of third party financing.

(3) The borrower may withdraw the prepayment request and be removed from the list of borrowers awaiting incentives and either continue operating the housing project for program purposes and in accordance with Agency requirements or

continue processing their prepayment process in accordance with §3560.658. If the borrower chooses to withdraw their request, the borrower may resubmit an updated prepayment request, at any time, and repeat the prepayment process in accordance with this subpart.

(4) The borrower may elect to obtain a third-party equity loan provided rents will not exceed comparable rents in the market area.

§3560.658 Borrower rejection of the incentive offer.

(a) If a borrower rejects the incentive package offered by the Agency or an Agency request to extended restrictive-use provisions, made in accordance with §3560.662, the loan will only be prepaid if the borrower elects to agree to the following:

(1) The borrower agrees to sign restrictive-use provisions to extend restrictive-use by 10 years from the date of prepayment, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(2) If housing opportunities for minorities would be lost as a result of prepayment, the borrower will offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(b) If the borrower does not elect or agree to enter an agreement in accordance with paragraph (a) of this section, then the Agency will assess the impact of prepayment on two factors: housing opportunities for minorities and the supply of decent, safe, sanitary, and affordable housing in the market area. The Agency will review relevant information to determine the availability of comparable affordable housing for existing tenants in the market area and if minorities in the project, on the waiting list or in the market area will be disproportionately adversely affected by the loss of the affordable rental housing units.

(1) If restrictive-use provisions are in place, the borrower will agree to sign the restrictive-use provisions, as determined by the Agency, and at the end of the restrictive-use period, offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(2) If restrictive-use provisions are in place, the borrower will agree to sign the restrictive-use provisions, as determined by the Agency, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with §3560.659.

(3) If the Agency determines that prepayment will have an adverse impact on minorities, then the borrower must offer to sell to a qualified nonprofit organization or public body in accordance with the provisions of paragraph (a) of this section.

(4) If the Agency determines that the prepayment will not have an adverse effect on housing opportunities for minorities but there is not an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant

households in the market area, the loan may be prepaid only if the borrower agrees to sign restrictive-use provisions, as determined by the Agency, to protect tenants at the time of prepayment.

(5) I f the Agency determines that there is no adverse impact on minorities and there is an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant households in the market area the prepayment will be accepted with no further restriction.

(c) If the borrower agrees to the restrictive-use provisions, as determined by the Agency, the applicable language must be included in the release documents and the borrower must execute a restrictive-use agreement acceptable to the Agency and a deed restriction.

(d) If the borrower will not agree to applicable restrictive-use provisions, as determined by the Agency, the borrower must offer to sell to a nonprofit or public body in accordance with §3560.659 or withdraw their prepayment request.

§3560.659 Sale or transfer to nonprofit organizations and public bodies.

(a) Sales price. For the purposes of establishing a sales price when a borrower is required or elects to sell a housing project to a nonprofit organization or public body, two independent appraisals will be ordered, one by the Agency and one by the borrower. Both appraisals will conclude market value and be in accordance with subpart P of this part. If the borrower's assessment of the Agency's appraised market value indicates that no further appraisal is needed, the borrower may agree to accept the Agency's appraisal.

(1) The expense of the borrower's appraisal shall be borne by the borrower. The appraiser selected may not have an identity of interest with the borrower.

(2) If the two appraisers fail to agree on the market value, the Agency and the borrower will jointly select an appraiser whose appraisal will be binding on the Agency and the borrower. The Agency and the borrower shall jointly fund the cost of the appraisal.

(b) Marketing to nonprofit organizations and public bodies. If a borrower must offer the property for sale to a nonprofit organization or public body under this paragraph, the borrower must take the following actions to inform appropriate entities of the sale:

(1) The borrower must advertise and offer to sell the project for a minimum of 180 days. The borrower may choose to suspend advertising and other sales efforts while eligibility of an interested purchaser is determined. If the purchaser is determined to be ineligible, the borrower must resume advertising for the balance of the required 180 days.

(2) The Agency will assist the borrower in initially notifying nonprofit organizations and public bodies.

(3) The borrower must provide the nonprofit organizations and public bodies contacted with sufficient information regarding the housing project and its operations for interested purchasers to make an informed decision. The information provided must include the minimum value of the housing project based on the market value determined in accordance with paragraph (a) of this section.

(4) If an interested purchaser requests additional information concerning the housing project, the borrower must promptly provide the requested materials.

(c) Preference for local nonprofit and public bodies. Local nonprofit organizations and public bodies have priority over regional and national nonprofit organizations and public bodies. The Agency may determine that no local nonprofit organizations or public bodies are available to purchase the housing project. After this determination, the borrower may accept an offer from a regional or national nonprofit organization or public body.

(d) Eligible nonprofit organizations. To be eligible to purchase properties under the conditions of this subpart, nonprofit organizations may not have among its officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under Section 515 that have been prepaid. In addition to local nonprofit organizations, eligible nonprofit organizations include regional or national nonprofit organizations or public bodies provided no part of the net earnings of which accrue to the benefit of any member, founder, contributor or individual.

(e) Requirements for nonprofit organizations and public bodies. To purchase and operate a housing project, a nonprofit organization or public body must meet the following requirements:

(1) The purchaser must agree to maintain the housing project for very low- and low-income families or persons for the remaining useful life of the housing and related facilities. However, currently eligible moderate-income tenants will not be required to move.

(2) The purchaser must agree that no subsequent transfer of the housing project will be permitted for the remaining useful life of the housing project unless the Agency determines that the transfer will further the provision of housing for low-income households, or there is no longer a need for the housing project. Language to be included in the deed, conveyance instrument, loan resolution, and assumption agreement (as applicable) is provided in §3560.662.

(3) The purchaser must demonstrate financial feasibility of the housing project including anticipated funding.

(4) The purchaser must certify to the Agency that no identity-of-interest relationships in accordance with §3560.102(g). The purchaser must not have any identity of interest with the seller or any borrower that has previously prepaid or requested prepayment of an Agency MFH loan.

(5) The purchaser must complete an Agency-approved application and obtain Agency approval in accordance with subpart B of this part.

(6) The purchaser must make a good faith offer taking into consideration the value of the housing project as determined in accordance with paragraph (a) of this section.

(f) Selection priorities. If more than one qualified nonprofit organization or public body submits an offer to purchase the project at the same time, priority will be given to local nonprofit organizations and public bodies over regional and national nonprofit organizations or public bodies. When selecting between offers equally meeting all other criteria, the borrower will first consider the success of the nonprofit organization's or public body's previous experience in developing and maintaining subsidized housing, with preference given to the most successful. If the offers continue to be equal, the borrower will then consider the number of years experience that the nonprofit organization or public body has had in developing and maintaining subsidized housing, with preference given to the greater number of years.

(g) Loans made by the Agency or other sources to nonprofit organizations and public bodies. Agency loans to nonprofit organizations or public bodies may be made for the purposes described in this paragraph. Agency loans will be processed in accordance with subpart B of this part. Loans from other sources will be approved by the Agency in accordance with subpart I of this part.

(1) Agency loans to nonprofit organizations or public bodies for the purchase of a housing project will be based on the appraised value determined in accordance with paragraph (a) of this section.

(2) With proper justification, an Agency loan may be made to help the nonprofit organization or public body meet the housing project's first year operating expenses if there are insufficient funds in the housing project's general operating and expense account to meet such expenses. An Agency loan, for the purpose of covering first year operating expenses, may not exceed 2 percent of the housing project's appraised value determined in accordance with paragraph (c) of this section.

(h) Advances for nonprofit organizations and public bodies. The Agency may make advances, in accordance with Section 502(c)(5)(c)(i), not in excess of limits established by Congress to nonprofit organizations or public bodies that are purchasing housing under this subpart. Grant funds may be used to cover any direct costs other than the purchase price, incurred by nonprofit organizations or public bodies in purchasing and assuming responsibility for the housing project.

(i) Waiting list. If funds for sales to nonprofit organizations and public bodies are limited, the Agency will add the funding requests to the waiting list for incentives and follow the process established in §3560.657(b) and (c).

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(j) Withdrawal from sales process. A borrower may withdraw the prepayment request at any time prior to the sale of the property. The borrower will be responsible for any damages associated with breaking a sales contract established with a nonprofit organization or public body.

(k) When no offer to purchase is received. Prepayment with no further restriction may be accepted by the Agency when the borrower agrees to offer the housing project for sale to a nonprofit organization or public body in accordance with §3560.659 and no good faith offer is received within 180 days from the date that the housing project was advertised for sale to a nonprofit organization or public body, or a good faith offer was received within 180 days from the advertisement date but the offeror was unable to fulfill the terms of the offer within 24 months of the offer date, provided the owner cooperated with the potential purchaser.

§3560.660 Acceptance of prepayments.

(a) When the Agency agrees to accept prepayment, the Agency will notify borrowers, in writing, of the conditions under which the Agency will accept prepayment including the specific restrictive-use provisions to which the borrower has agreed and the date by which the borrower must make the prepayment.

(1) Prepayment must be made 180 days from the date of the Agency's prepayment acceptance notice to the borrower.

(2) If the borrower's prepayment is not received within 180 days of the prepayment acceptance notice and the Agency has not agreed to an alternative date based on a written request from the borrower, the Agency may cancel the prepayment acceptance agreement.

(b) Owners will provide certification stating that they will meet State and local laws prior to prepayment acceptance.

(c) Tenants will be notified of the prepayment acceptance agreement in accordance with §3560.654(c). If a prepayment is anticipated to result in increased net tenant contributions, displacements or involuntary relocations, the tenants, who are affected by such a circumstance, may request a Letter Of Priority Entitlement (LOPE) in accordance with §3560.159(c). Tenants must request a LOPE within one year of the prepayment acceptance notice date.

§3560.661 Sale or transfers.

(a) If a sale or transfer is to take place in conjunction with the Agency incentive offer, the sale or transfer must comply with the processing provisions of subpart I of this part.

(b) If a proposed transferee is determined not to be eligible for the transfer and assumption, the borrower will be given an additional 45 days to find another transferee.

(c) In cases where the existing owner is in program non-compliance or default, the Agency may make an offer of incentives contingent on the successful transfer of the

housing to an acceptable purchaser. The Agency may offer a smaller incentive or no incentive if the borrower does not agree to transfer the project to an acceptable purchaser, or if the transfer does not take place.

§3560.662 Restrictive-use provisions and agreements.

All restrictions require Agency approval and must be in accordance with the following restrictions:

(a) The undersigned, and any successors in interest, agree to use the property (described herein) in compliance with 42 U.S.C. 1484 or 1485, whichever is applicable, and applicable regulations and the subsequent amendments, for the purpose of housing:

(1) Very low-, or low-income households when required by §3560.658(a)(3), or

(2) Very low-, low-, or moderate-income households.

(b) The period of the restriction will be inserted in accordance with the following:

(1) 10 years if required by §3560.658(a)(1);

(2) The last existing tenant (that occupied the property on the date of prepayment) voluntarily vacates if required by §3560.658(b)(2)

(3) 30 years if required by §3560.406(g);

(4) Remaining period of existing restrictive-use provisions and any agreed extension if required by §3560.655 or §3560.658 (a)(2);

(5) The remaining useful life of the housing and related facilities if required by §3560.658(a)(3); and

(6) 20 years in all other cases.

(c) When required by §3560.658(a)(1) or (a)(2), the undersigned agrees that at the end of the expiration of the period described in paragraph (b) of this section, the property will be offered for sale to a qualified nonprofit organization or public body, in accordance with previously cited statutes and regulations.

(d) The Agency and eligible tenants or applicants may enforce these restrictions.

(e) The undersigned also agrees to:

(1) To set rents, other charges, and conditions of occupancy in a manner to meet these restrictions;

(2) To post an Agency approved notice of this restriction for the tenants of the property;

(3) To adhere to applicable local, State, and Federal laws; and

(4) To obtain Agency concurrence for any rental procedures that deviate from those approved at the time of prepayment, prior to implementation.

(f) The undersigned will be released from these obligations before the termination period in paragraph (b) of this section only when the Agency determines that there is no longer a need for the housing or that financial assistance provided the residents of the housing will no longer be provided due to no fault, action or lack of action on the part of the borrower.

§3560.663 Post-payment responsibilities for loans subject to continued restrictive-use provisions.

(a) If a borrower prepays a loan and the housing project remains subject to restrictive-use provisions, the requirements of this section apply after prepayment.

(b) Owners of prepaid housing projects will be responsible for ensuring that the restrictive-use provisions agreed to as a condition of prepayment are observed.

(c) Owners must maintain appropriate documentation to demonstrate compliance with the restrictive-use provisions and must make the documentation and the housing project site available for Federal Government inspection upon request.

(1) Owners must document rent increases in accordance with subpart G of this part.

(2) Owners must document tenant eligibility in accordance with §3560.152.

(3) In an Agency approved format, owners must provide the Agency with a signed and dated certification within 30 days of the beginning of each calendar year for the full period of the restrictive-use provisions establishing that the restrictive-use provisions are being met.

(d) Owners must observe Agency policies on tenant grievances as described in §3560.160. The Agency may enforce restrictive-use provisions through administrative and legal actions. Tenants may enforce the restrictive-use provisions by contacting the Agency or through legal action. The Agency will release the restrictive-use provisions when the Agency conditions have been met.

§3560.664-3560.699 [Reserved]

§3560.700 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart O--Unauthorized Assistance

§3560.701 General.

(a) This subpart contains the policies for recapturing unauthorized assistance when the Agency determines that a borrower or tenant was ineligible for, or improperly used, assistance received from the Agency.

(b) The Agency may seek repayment of any unauthorized assistance provided to a borrower or tenant, plus the cost of collection, regardless of whether the unauthorized assistance was due to errors by the Agency, the borrower, or the tenant.

§3560.702 Unauthorized assistance sources and situations.

(a) Unauthorized assistance can be received by a borrower or tenant in the form of loans, grants, interest credit, rental assistance, or other assistance provided by the Agency including assistance received as a result of an incorrect interest rate being applied to an Agency loan. Agency officials may pursue identification and recapture of unauthorized assistance through any legal remedies available.

(b) Unauthorized assistance may result from situations such as:

(1) Assistance being provided to an ineligible borrower or tenant;

(2) Assistance to an eligible borrower or tenant being used for an unauthorized purpose;

(3) Assistance being obtained as a result of inaccurate, incomplete, or fraudulent information provided by a borrower or tenant; or

(4) Assistance being obtained as a result of errors by the Agency, borrower, or tenant.

§3560.703 Identification of unauthorized assistance.

(a) The Agency will use all available means to identify unauthorized assistance, including Agency monitoring activities, OIG reports, GAO reports, and reports from any source, if the information provided can be substantiated by the Agency.

(b) Borrowers have the primary responsibility for identifying repayment of unauthorized assistance received by tenants.

§3560.704 Unauthorized assistance determination notice.

(a) The Agency will notify borrowers, in writing, when a determination has been made that unauthorized assistance was received by the borrower. Borrowers will notify tenants, in writing, when a determination is made that unauthorized assistance was received by the tenant and will simultaneously send the Agency of copy of the written notice to the tenant.

(b) The unauthorized assistance determination notice is a preliminary notice, not a demand letter. The unauthorized assistance determination notice will:

(1) Specify the reasons the assistance was determined to be unauthorized;

(2) State the amount of unauthorized assistance to be repaid and specify the party responsible for repayment of the unauthorized assistance (i.e., the tenant or borrower) according to the provision of §3560.708;

(3) Establish a place and time when the person receiving the unauthorized assistance determination notice may meet with the Agency or, in the case of tenants, may meet with the borrower, to discuss issues related to the unauthorized assistance notice such as the establishment of a repayment schedule; and

(4) Advise the borrower or tenant that they may present facts, figures, written records, or other information within a specified period of time which might alter the determination that the assistance received was unauthorized.

(c) Upon request, the Agency or borrower, in the case of tenants, will grant additional time for discussions related to an unauthorized assistance determination notice. Borrowers must notify the Agency of schedule revisions when additional time is granted to a tenant in unauthorized assistance claims.

§3560.705 Recapture of unauthorized assistance.

(a) The Agency will seek repayment of all unauthorized assistance received by a borrower or tenant, plus the cost of collection, to the fullest extent permitted by law. Agency efforts to collect unauthorized assistance may include offsets, the use of private or public collection agents, and any other remedies available. Agency findings related to unauthorized assistance determinations will be referred to credit reporting bureaus and other federal, state, or local agencies with jurisdictions related to the unauthorized assistance findings for suspension, debarment, civil or criminal action to the fullest extent permitted by law.

(b) If a borrower or tenant agrees to repay unauthorized assistance, the amount due will be the amount stated in the unauthorized assistance determination notice unless another amount has been approved by the Agency.

(c) Repayment may be made either with a lump sum payment or through payments made over a period of time. If a borrower or tenant agrees to repay unauthorized assistance, the borrower or tenant proposed repayment schedule must be approved by Agency prior to implementation. Agency approval of a repayment schedule will take into consideration the best interest of the borrower, the tenant, and the Federal Government.

(d) Borrowers must retain copies of all correspondence and a record of all conversations between the borrower and a tenant regarding unauthorized assistance received by a tenant.

(e) When a tenant, who has received unauthorized assistance due to tenant error or fraud as determined by the Agency, moves out of a housing project, the borrower is no longer responsible for recapturing the unauthorized assistance provided that the borrower notifies the Agency of the tenant's move and transfers all records related to the tenant's unauthorized assistance to the Agency within 30 days of the tenant's move. The Agency will pursue collection of the unauthorized assistance from the tenant.

(f) If a borrower refuses to enter into an unauthorized assistance repayment schedule with the Agency, the Agency will initiate liquidation procedures, in accordance with §3560.456, or other enforcement actions, such as suspension, debarment, civil, or criminal penalties, in accordance with §3560.461. If a tenant refuses to enter into an unauthorized assistance repayment schedule, the Agency will initiate recovery actions against the tenant.

(g) Borrowers may not use housing project funds to pay amounts due to the Agency as a result of unauthorized assistance due to borrower fraud.

§3560.706 Offsets.

Offsets and any other available remedies may be used by the Agency to recapture unauthorized assistance. Guidance concerning use of offsets can be found at 7 CFR 3550.210.

§3560.707 Program participation and corrective actions.

(a) With Agency approval, a borrower or tenant, who has received unauthorized assistance, may continue to participate in the project if they have the legal and financial capabilities to do so. Approval considerations for such forbearance and repayment are in §3560.705.

(b) A borrower or tenant who was responsible for the circumstances causing the unauthorized assistance must take appropriate action to correct the problem within 90 days of the unauthorized assistance determination notice date, unless an alternative date is agreed to by the Agency.

(c) When the interest rate shown in a debt instrument resulted in the receipt of unauthorized assistance, the debt instrument will be modified to the correct interest rate. All payments made by the borrower at the incorrect interest rate will be reapplied at the correct interest rate, and remaining payments due on the loan will be recalculated on the basis of the correct interest rate, plus any amounts due to the Agency as a result of the use of an incorrect interest rate, unless the Agency agrees to a separate repayment process.

§3560.708 Unauthorized assistance received by tenants.

(a) Tenant actions that require tenant repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Knowingly or mistakenly misrepresenting income, assets, adjustments to income, or household status to the borrower as required under subpart D of this part; or

(2) Failure to properly report changes in income, assets, adjustments to income, or household status to the borrower as required in subpart D of this part.

(b) Borrower actions that require borrower repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Incorrect determination of tenant income or household status by the borrower, resulting in rental assistance or interest credit that is not allowable under the provisions of subparts D, E, or F of this part, as applicable; or

(2) Assignment of rental assistance to a household that is ineligible under the requirements of subpart F of this part.

(c) When it is determined that a tenant has received unauthorized assistance, the borrower shall notify the tenant and the Agency through the procedure specified in §3560.704.

(d) Borrowers may not charge tenants to pay amounts due to the Agency as a result of unauthorized assistance to tenants through borrower error.

(e) Borrowers must notify the Agency of all collections from tenants as repayments for unauthorized assistance and must remit or credit the amounts collected to applicable housing project accounts.

(f) When rental assistance was improperly assigned to a tenant, for any reason, the rental assistance benefit must be canceled and reassigned.

(1) Before a borrower notifies a tenant of rental assistance cancellation, the borrower must request Agency approval. If the Agency determines that the unauthorized rental assistance was received by the tenant due to borrower fraud or error, the borrower must give the tenant 30 days notice, in writing, that the unit was assigned in error and that the rental assistance benefit will be canceled effective on date that the next monthly rental payment is due after the end of the 30-day notice period.

(2) Tenants also must be notified, in writing, that they may cancel their lease without penalty at the time the rental assistance is canceled. Tenants must be offered an opportunity to meet with a borrower to discuss the rental assistance cancellation.

§3560.709 Demand letter.

(a) If a borrower fails to respond to an unauthorized assistance determination notice or fails to agree to a repayment schedule, the Agency will send the borrower a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination; and

(2) The actions to be taken by the Agency if repayment is not made by a specified date.

(b) If a tenant fails to respond to the unauthorized assistance determination notice or fails to agree to a repayment schedule, the borrower will send the tenant a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination;

(2) The actions to be taken if repayment is not made by a specified date, including termination of tenancy; and

(3) The appeal rights of the tenant as specified in §3560.160.

(c) A demand letter may be sent to a borrower or tenant, in lieu of an unauthorized assistance determination notice, when the evidence documenting the unauthorized assistance determination is deemed to be conclusive by the Agency or borrower sending the letter.

§§3560.710-3560.749 [Reserved]

§3560.750 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

Subpart P--Appraisals

§3560.751 General.

This subpart sets forth appraisal policies for Agency-financed multi-family housing (MFH) projects consisting of five or more rental units. Agency-financed housing projects with fewer than five rental units may be appraised in accordance with the Agency's single family housing appraisal policies established under 7 CFR 3550.62.

§3560.752 Appraisal use, request, review, and release.

(a) Appraisal uses. The Agency will use appraisals to determine whether the security offered by an applicant or borrower is adequate to secure a loan or determine appropriate servicing or preservation decisions. Appraisals used for Agency decision-making must be current, unless the Agency and the applicant, or borrower, mutually agree to the use of an appraisal that is not current. A current appraisal is an appraisal with a report date that is not more than one year old.

(b) Appraisal requests. Appraisal requests must be in writing and must specify the client and other intended users, the intended use, the purpose, and the scope of work of the appraisal, including the type and definition of the value(s) to be developed.

(1) Type of Value. The appraisal request must indicate whether the “market value”, the “market value, subject to restricted rents”, or any other type of value of the housing project and related facilities is to be concluded.

(i) A request for “market value, subject to restricted rents” means the appraisal will take into consideration any rent limits, rent subsidies, expense abatements, or restrictive-use conditions that will affect the property as a result of an agreement with the Agency or any other financing source. Each type of financing involved, including, but not limited to, interest credit subsidy, low-interest loans from other sources,

tax-exempt bond financing, tax credits, and grants, must be valued separately in the appraisal.

(ii) A request for “market value” means the appraisal will take into consideration the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and

assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(A) Buyer and seller are typically motivated;

(B) Both parties are well informed or well advised and acting in what they consider their best interests;

(C) A reasonable time is allowed for exposure in the open market;

(D) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and

(E) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(2) "As-is Value" or "Prospective Value". The appraisal request must indicate whether the "as-is value" or "prospective value" of the housing is to be concluded.

(i) "As-is value" means the value of the housing and related facilities as of the effective date of the appraisal. It relates to what physically exists and is legally permissible at the time of the appraisal and excludes all hypothetical conditions.

(ii) "Prospective value" means the forecasted value of the housing and related facilities as of a specified future date. For Agency appraisals, this date will typically be the projected completion date of proposed new construction or rehabilitation.

(3) Section 8 project-based assistance. Depending on the intended use of the appraisal, the Agency will specify whether or not section 8 project-based assistance will be considered in the valuation of the housing. The remaining term of the section 8 contract and the probability of subsequent renewal terms being authorized will be taken into consideration when making this determination.

(4) Low-Income Housing Tax Credit (LIHTC) and other financing sources. Depending on the intended use of the appraisal, the Agency will specify whether or not tax credits and other financing sources involved in the housing will be considered in the valuation of the housing.

(c) Appraisal review. All MFH appraisals that were not written by an Agency appraiser will be reviewed by an Agency appraiser, who will write and file a technical review report that complies with the Uniform Standards of Professional Appraisal Practice (USPAP) and Agency requirements.

(d) Release of appraisals. MFH appraisals procured by the Agency will be released to owners/applicants, from their own files, upon their request.

§3560.753 Agency appraisal standards and requirements.

(a) General. The Agency recognizes USPAP as the basic standards for appraisals. Appraisals used by the Agency must comply with USPAP and this subpart.

(b) Appraisers. MFH appraisals prepared for the Agency will be written by Agency appraisers or independent fee appraisers who are state certified general appraisers, certified in the state where the property is located. Technical review reports will be written by Agency state certified general appraisers.

(c) Appraisal report. The appraisal report format may be a form appraisal or a narrative appraisal. The Agency will specify the appraisal format that is most appropriate for the scope of work involved when the appraisal is requested.

(1) Form appraisal reports. The Agency will accept appraisal report forms that meet generally accepted industry standards, comply with USPAP, and have been approved by the Agency.

(2) Narrative appraisal reports. Narrative appraisal reports must, at a minimum, contain the following items:

(i) Transmittal letter;

(ii) Factual information about the property;

(iii) Regional and neighborhood data;

(iv) Description of the subject property;

(v) Description of existing and planned improvements;

(vi) A highest and best use analysis;

(vii) A statement regarding any environmental issues, such as potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products;

(viii) A cost approach analysis (if applicable);

(ix) A sales comparison approach analysis (if applicable);

(x) An income approach analysis (if applicable);

(xi) A reconciliation of the value indications derived from the included approaches to value; and

(xii) A signed and dated certification of value.

(3) At the time an appraisal is requested, the Agency will specify either a complete or a limited appraisal and one of the following types of appraisal reports, based upon the complexity of the appraisal assignment.

(i) A self-contained report that comprehensively describes all information significant to the solution of the appraisal problem;

(ii) A summary report that summarizes all information significant to the solution of the appraisal problem; or

(iii) A restricted use report, intended for Agency use only, that briefly states all

information significant to the solution of the appraisal problem.

(d) Highest and best use statement and analysis. The highest and best use is to be concluded for the subject site as though it was vacant, and for the subject property as improved, if improvements have been made. If the highest and best use of a subject property is for something other than MFH, the appraisal report must provide this information to the Agency for consideration in the loan process. In addition to being reasonably probable and appropriately supported, the highest and best use of both the land as though vacant and the property as improved must meet four implicit criteria. The highest and best use must be:

(1) Physically possible;

(2) Legally permissible;

(3) Financially feasible; and

(4) Maximally productive.

(e) Valuation methods and variances. The final opinion of value presented in an appraisal report must have considered a cost approach, a sales comparison approach, and an income approach. If one of these standard approaches is not used, the reconciliation narrative will provide a full and complete explanation of the reasons the approach was excluded. The reconciliation will fully discuss and reconcile variances in the value indications concluded by each approach.

(f) Real estate history. Appraisals must contain a 5-year ownership and sales history for the housing project being appraised.

(g) Reserve accounts. Funds in the housing project's reserve account will not be considered in the valuation of the housing project.

(h) Escrow accounts. Short-term prepaid escrow accounts for general operating expenses, such as taxes and insurance, shall not be considered in the valuation of the housing project.

(i) Rental rates comparison. The appraisal report must document whether the housing project's basic rents are less than, equal to, or greater than market rents for comparable conventional, or non-subsidized, units in the area where the housing is located.

(j) Description of housing and property rights. The appraisal report must identify and describe both the real estate, which is the land and improvements, and the real property, or property rights, being appraised.

(k) Exclusion of rental units from valuation. The Agency will provide appraisers with instructions and supporting information on any rental units that do not produce rental income at the time of the appraisal.

(l) Non-contiguous sites. When a housing project has real property located on non-contiguous sites, a separate appraisal must be developed for each site.

§§3560.754-3560.799 [Reserved]

§3560.800 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

APPENDIX 2

7 CFR Part 11—NATIONAL APPEALS DIVISION

Subpart A – National Appeals Division Rules of Procedure

Sec.

11.1 Definitions.
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11.12 Effective date and implementation of final determinations of the Division.
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11.14 Filing of appeals and computation of time.

AUTHORITY: 5 U.S.C. 301; Title II, Subtitle H, Pub. L. 103-354, 108 Stat. 3228 (7 U.S.C. 6991 *et seq.)*; Reorganization Plan No. 2 of 1953 (5 U.S.C. App.).

§ 11.1 Definitions.

For purposes of this part:

Adverse decision means an administrative decision made by an officer, employee, or committee of an agency that is adverse to a participant. The term includes a denial of equitable relief by an agency or the failure of an agency to issue a decision or otherwise act on the request or right of the participant within timeframes specified by agency program statutes or regulations or within a reasonable time if timeframes are not specified in such statutes or regulations. The term does not include a decision over which the Board of Contract Appeals has jurisdiction.

Agency means:

1. The Agricultural Stabilization and Conservation Service (ASCS);
2. The Commodity Credit Corporation (CCC);
3. The Farm Service Agency (FSA);
4. The Federal Crop Insurance Corporation (FCIC);
5. The Natural Resources Conservation Service (NRCS);
6. The Risk Management Agency (RMA);
7. The Rural Business-Cooperative Service (RBS);
8. Rural Development (RD);
9. The Rural Housing Service (RHS);
10. The Rural Utilities Service (RUS) (but not for programs authorized by the Rural Electrification Act of 1936 or the Rural Telephone Bank Act, 7 U.S.C. 901 et seq.);
11. The Soil Conservation Service (SCS);
12. A State, county, or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act (16 U.S.C. 590h(b)(5)); and
13. Any predecessor or successor agency to the above-named agencies, and any other agency or office of the Department which the Secretary may designate.

Agency record means all the materials maintained by an agency related to an adverse decision which are submitted to the Division by an agency for consideration in connection with an appeal under this part, including all materials prepared or reviewed by the agency during its consideration and decisionmaking process, but shall not include records or information not related to the adverse decision at issue. All materials contained in the agency record submitted to the Division shall be deemed admitted as evidence for purposes of a hearing or a record review under §11.8.

Agency representative means any person, whether or not an attorney, who is authorized to represent the agency in an administrative appeal under this part.

Appeal means a written request by a participant asking for review by the National Appeals Division of an adverse decision under this part.

Appellant means any participant who appeals an adverse decision in accordance with this part. Unless separately set forth in this part, the term "appellant" includes an authorized representative.

Authorized representative means any person, whether or not an attorney, who is authorized in writing by a participant, consistent with §11.6(c), to act for the participant in an administrative appeal under this part. The authorized representative may act on behalf of the participant except when the provisions of this part require action by the participant or appellant personally.

Case record means all the materials maintained by the Secretary related to an adverse decision. The case record includes both the agency record and the hearing record.

Days means calendar days unless otherwise specified.

Department means the United States Department of Agriculture (USDA).

Director means the Director of the Division or a designee of the Director.

Division means the National Appeals Division established by this part.

Equitable relief means relief which is authorized under section 326 of the Food and Agriculture Act of 1962 (7 U.S.C. 1339a) and other laws administered by the agency.

Ex parte communication means an oral or written communication to any officer or employee of the Division with respect to which reasonable prior notice to all parties is not given, but it shall not include requests for status reports, or inquiries on Division procedure, in reference to any matter or proceeding connected with the appeal involved.

Hearing, except with respect to §11.5, means a proceeding before the Division to afford a participant the opportunity to present testimony or documentary evidence or both in order to have a previous determination reversed and to show why an adverse determination was in error.

Hearing Officer means an individual employed by the Division who conducts the hearing and determines appeals of adverse decisions by any agency.

Hearing record means all documents, evidence, and other materials generated in relation to a hearing under §11.8.

Implement means the taking of action by an agency of the Department in order fully and promptly to effectuate a final determination of the Division.

Participant means any individual or entity who has applied for, or whose right to participate in or receive, a payment, loan, loan guarantee, or other benefit in accordance with any program of an agency to which the regulations in this part apply is affected by a decision of such agency. The term does not include persons whose claim(s) arise under:

1. Programs subject to various proceedings provided for in 7 CFR part 1;

2. Programs governed by Federal contracting laws and regulations (appealable under other rules and to other forums, including to the Department's Board of Contract Appeals under 7 CFR part 24);

3. The Freedom of Information Act (appealable under 7 CFR part 1, subpart A);
4. Suspension and debarment disputes, including, but not limited to, those falling within the scope of 7 CFR parts 1407 and 3017;
5. Export programs administered by the Commodity Credit Corporation;
6. Disputes between reinsured companies and the Federal Crop Insurance Corporation;
7. Tenant grievances or appeals prosecutable under the provisions of 7 CFR part 1944, subpart L, under the multi-family housing program carried out by RHS;
8. Personnel, equal employment opportunity, and other similar disputes with any agency or office of the Department which arise out of the employment relationship;
9. The Federal Tort Claims Act, 28 U.S.C. 2671 et seq., or the Military Personnel and Civilian Employees Claims Act of 1964, 31 U.S.C. 3721;
10. Discrimination complaints prosecutable under the nondiscrimination regulations at 7 CFR parts 15, 15a, 15b, 15e, and 15f; or
11. Section 361, et seq., of the Agricultural Adjustment Act of 1938, as amended (7 U.S.C. 1361, et seq.) involving Tobacco Marketing Quota Review Committees.

Record review means an appeal considered by the Hearing Officer in which the Hearing Officer's determination is based on the agency record and other information submitted by the appellant and the agency, including information submitted by affidavit or declaration.

Secretary means the Secretary of Agriculture.

§ 11.2 General statement.

(a) This part sets forth procedures for proceedings before the National Appeals Division within the Department. The Division is an organization within the Department, subject to the general supervision of and policy direction by the Secretary, which is independent from all other agencies and offices of the Department, including Department officials at the state and local level. The Director of the Division reports directly to the Secretary of Agriculture. The authority of the Hearing Officers and the Director of the Division, and the administrative appeal procedures which must be followed by program participants who desire to appeal an adverse decision and by the agency which issued the adverse decision, are included in this part.

(b) Pursuant to section 212(e) of the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, Pub. L. 103-354 (the Act), 7 U.S.C. 6912(e), program participants shall seek review of an adverse decision before a Hearing Officer of the Division, and may seek further review by the Director, under the provisions of this part prior to seeking judicial review.

§ 11.3 Applicability.

(a) Subject matter. The regulations contained in this part are applicable to adverse decisions made by an agency, including, for example, those with respect to:

1. Denial of participation in, or receipt of benefits under, any program of an agency;
2. Compliance with program requirements;
3. The making or amount of payments or other program benefits to a participant in any program of an agency; and
4. A determination that a parcel of land is a wetland or highly erodible land.

(b) Limitation. The procedures contained in this part may not be used to seek review of statutes or USDA regulations issued under Federal Law.

§ 11.4 Inapplicability of other laws and regulations.

(a) Reserved.

(b) The Federal Rules of Evidence, 28 U.S.C. App., shall not apply to proceedings under this part.

§ 11.5 Informal review of adverse decisions.

(a) Required informal review of FSA adverse decisions. Except with respect to farm credit programs, a participant must seek an informal review of an adverse decision issued at the field service office level by an officer or employee of FSA, or by any employee of a county or area committee established under section 8(b)(5) of the Soil Conservation and Domestic Allotment Act, 16 U.S.C. 590h(b)(5), before NAD will accept an appeal of a FSA adverse decision. Such informal review shall be done by the county or area committee with responsibility for the adverse decision at issue. The procedures for requesting such an informal review before FSA are found in 7 CFR part 780. After receiving a decision upon review by a county or area committee, a participant may seek further informal review by the State FSA committee or may appeal directly to NAD under §11.6(b).

(b) Optional informal review. With respect to adverse decisions issued at the State office level of FSA and adverse decisions of all other agencies, a participant may request an agency informal review of an adverse decision of that agency prior to appealing to NAD. Procedures for requesting such an informal review are found at 7 CFR part 780 (FSA), 7 CFR part 614 (NRCS), 7 CFR part 1900, subpart B (RUS), 7 CFR part 1900, subpart B (RBS), and 7 CFR part 1900, subpart B (RHS).

(c) Mediation. A participant also shall have the right to utilize any available alternative dispute resolution (ADR) or mediation program, including any mediation program available under title V of the Agricultural Credit Act of 1987, 7 U.S.C. 5101 et seq., in order to attempt to seek resolution of an adverse decision of an agency prior to a NAD hearing. If a participant:

1. Requests mediation or ADR prior to filing an appeal with NAD, the participant stops the running of the 30-day period during which a participant may appeal to NAD under §11.6(b)(1), and will have the balance of days remaining in that period to appeal to NAD once mediation or ADR has concluded.

2. Requests mediation or ADR after having filed an appeal to NAD under §11.6(b), but before the hearing, the participant will be deemed to have waived his right to have a hearing within 45 days under §11.8(c)(1) but shall have a right to have a hearing within 45 days after conclusion of mediation or ADR.

§ 11.6 Director review of agency determination of appealability and right of participants to Division hearing.

(a) Director review of agency determination of appealability.

1. Not later than 30 days after the date on which a participant receives a determination from an agency that an agency decision is not appealable, the participant must submit a written request personally signed by the participant to the Director to review the determination in order to obtain such review by the Director.

2. The Director shall determined whether the decision is adverse to the individual participant and thus appealable or is a matter of general applicability and thus not subject to appeal, and will issue a final determination notice that upholds or reverses the determination of the agency. This final determination is not appealable. If the Director reverses the determination of the agency, the Director will notify the participant and the agency of that decision and inform the participant of his or her right to proceed with an appeal.

3. The Director may delegate his or her authority to conduct a review under this paragraph to any subordinate official of the Division other than a Hearing Officer. In any case in which such review is conducted by such a subordinate official, the subordinate official's determination shall be considered to be the determination of the Director and shall be final and not appealable.

(b) Appeals of adverse decisions.

1. To obtain a hearing under §11.8, a participant personally must request such hearing not later than 30 days after the date on which the participant first received notice of the adverse decision or after the date on which the participant receives notice of the Director's determination that a decision is appealable. In the case of the failure of an agency to act on the request or right of a recipient, a participant personally must request such hearing not later than 30 days after the participant knew or reasonably should have known that the agency had not acted within the timeframes specified by agency program regulations, or, where such regulations specify no timeframes, not later than 30 days after the participant reasonably should have known of the agency's failure to act.

2. A request for a hearing shall be in writing and personally signed by the participant, and shall include a copy of the adverse decision to be reviewed, if available, along with a brief statement of the participant's reasons for believing that the decision, or the agency's failure to act, was wrong. The participant also shall send a copy of the request for a hearing to the agency, and may send a copy of the adverse decision to be reviewed to the agency, but failure to do either will not constitute grounds for dismissal of the appeal. Instead of a hearing, the participant may request a record review.

(c) If a participant is represented by an authorized representative, the authorized representative must file a declaration with NAD, executed in accordance with 28 U.S.C. 1746, stating that the participant has duly authorized the declarant in writing to represent the participant for purposes of a specified adverse decision or decisions, and attach a copy of the written authorization to the declaration.

§ 11.7 Ex parte communications.

(a) Ex parte communications.

(1) At no time between the filing of an appeal and the issuance of a final determination under this part shall any officer or employee of the Division engage in ex parte communications regarding the merits of the appeal with any person having any interest in the appeal pending before the Division, including any person in an advocacy or investigative capacity. This prohibition does not apply to:

1. Discussions of procedural matters related to an appeal; or

2. Discussions of the merits of the appeal where all parties to the appeal have been given notice and an opportunity to participate.

(2) In the case of a communication described in paragraph (a)(1)(ii) of this section, a memorandum of any such discussion shall be included in the hearing record.

(b) No interested person shall make or knowingly cause to be made to any officer or employee of the Division an ex parte communication relevant to the merits of the appeal.

(c) If any officer or employee of the Division receives an ex parte communication in violation of this section, the one who receives the communication shall place in the hearing record:

1. All such written communications;

2. Memoranda stating the substance of all such oral communications; and

3. All written responses to such communications, and memoranda stating the substance of any oral responses thereto.

(d) Upon receipt of a communication knowingly made or knowingly caused to be made by a party in violation of this section the Hearing Officer or Director may, to the extent consistent with the interests of justice and the policy of the underlying program, require the party to show cause why such party's claim or interest in the appeal should not be dismissed, denied, disregarded, or otherwise adversely affected on account of such violation.

§ 11.8 Division hearings.

(a) General rules.

1. The Director, the Hearing Officer, and the appellant shall have access to the agency record of any adverse decision appealed to the Division for a hearing. Upon request by the appellant, the agency shall provide the appellant a copy of the agency record.

2. The Director and Hearing Officer shall have the authority to administer oaths and affirmations, and to require, by subpoena, the attendance of witnesses and the production of evidence. A Hearing Officer shall obtain the concurrence of the Director prior to issuing a subpoena.

   i. A subpoena requiring the production of evidence may be requested and issued at any time while the case is pending before the Division.

   ii. An appellant or an agency, acting through any appropriate official, may request the issuance of a subpoena requiring the attendance of a witness by submitting such a request in writing at least 14 days before the scheduled date of a hearing.

The Director or Hearing Officer shall issue a subpoena at least 7 days prior to the scheduled date of a hearing.

iii. A subpoena shall be issued only if the Director or a Hearing Officer determined that:

A. For a subpoena of documents, the appellant or the agency has established that production of documentary evidence is necessary and is reasonably calculated to lead to information which would affect the final determination or is necessary to fully present the case before the Division; or

B. For a subpoena of a witness, the appellant or the agency has established that either a representative of the Department or a private individual possesses information that is pertinent and necessary for disclosure of all relevant facts which could impact the final determination, that the information cannot be obtained except through testimony of the person, and that the testimony cannot be obtained absent issuance of a subpoena.

iv. The party requesting issuance of a subpoena shall arrange for service. Service of a subpoena upon a person named therein may be made by registered or certified mail, or in person. Personal service shall be made by personal delivery of a copy of the subpoena to the person named therein by any person who is not a party and who is not less than 18 years of age. Proof of service shall be made by filing with the Hearing Officer or Director who issued the subpoena a statement of the date and manner of service and of the names of the persons served, certified by the person who made the service in person or by return receipts for certified or registered mail.

v. A party who requests that a subpoena be issued shall be responsible for the payment of any reasonable travel and subsistence costs incurred by the witness in connection with his or her appearance and any fees of a person who serves the subpoena in person. The Department shall pay the costs associated with the appearance of a Department employee whose role as a witness arises out of his or her performance of official duties, regardless of which party requested the subpoena.

The failure to make payment of such charges on demand may be deemed by the Hearing Officer or Director as sufficient ground for striking the testimony of the witness and the evidence the witness has produced.

vi. If a person refuses to obey a subpoena, the Director, acting through the Office of the General Counsel of the Department and the Department of Justice, may apply to the United States District Court in the jurisdiction where that person resides to have the subpoena enforced as provided in the Federal Rules of Civil Procedure (28 U.S.C. App.).

3. Testimony required by subpoena pursuant to paragraph (a)(2) of this section may, at the discretion of the Director or a Hearing Officer, be presented at the hearing either in person or telephonically.

(b) Hearing procedures applicable to both record review and hearings.

1. Upon the filing of an appeal under this part of an adverse decision by any agency, the agency promptly shall provide the Division with a copy of the agency record. If requested by the applicant prior to the hearing, a copy of such agency record shall be provided to the appellant by the agency within 10 days of receipt of the request by the agency.

2. The Director shall assign the appeal to a Hearing Officer and shall notify the appellant and agency of such assignment. The notice also shall advise the appellant and the agency of the documents required to be submitted under paragraph (c)(2) of this section, and notify the appellant of the option of having a hearing by telephone.

3. The Hearing Officer will receive evidence into the hearing record without regard to whether the evidence was known to the agency officer, employee, or committee making the adverse decision at the time the adverse decision was made.

(c) Procedures applicable only to hearings.

1. Upon a timely request for a hearing under §11.6(b), an appellant has the right to have a hearing by the Division on any adverse decision within 45 days after the date of receipt of the request for the hearing by the Division.

2. The Hearing Officer shall set a reasonable deadline for submission of the following documents:

i. By the appellant:

A. A short statement of why the decision is wrong;

B. A copy of any document not in the agency record that the appellant anticipates introducing at the hearing; and

C. A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

ii. By the agency:

A. A copy of the adverse decision challenged by the appellant;

B. A written explanation of the agency's position, including the regulatory or statutory basis therefor;

C. A copy of any document not in the agency record that the agency anticipates introducing at the hearing; and

D. A list of anticipated witnesses and brief descriptions of the evidence such witnesses will offer.

iii. Not less than 14 days prior to the hearing, the Division must provide the appellant, the authorized representative, and the agency a notice of hearing specifying the date, time, and place of the hearing. The hearing will be held in the State of residence of the appellant, as determined by the Hearing Officer, or at a location that is otherwise convenient to the appellant, the agency, and the Division. The notice also shall notify all parties of the right to obtain an official record of the hearing.

iv. Pre-hearing conference. Whenever appropriate, the Hearing Officer shall hold a pre-hearing conference in order to attempt to resolve the dispute or to narrow the issues involved. Such pre-hearing conference shall be held by telephone unless the Hearing Officer and all parties agree to hold such conference in person.

v. Conduct of the hearing.

i. A hearing before a Hearing Officer will be in person unless the appellant agrees to a hearing by telephone.

ii. The hearing will be conducted by the Hearing Officer in the manner determined by the Division most likely to obtain the facts relevant to the matter or matters at issue. The Hearing Officer will allow the presentation of evidence at the hearing by any party without regard to whether the evidence was known to the officer, employee, or committee of the agency making the adverse decision at the time the adverse decision was made.

The Hearing Officer may confine the presentation of facts and evidence to pertinent matters and exclude irrelevant, immaterial, or unduly repetitious evidence, information, or questions. Any party shall have the opportunity to present oral and documentary evidence, oral testimony of witnesses, and arguments in support of the party's position; controvert evidence relied on by any other party; and question all witnesses. When appropriate, agency witnesses requested by the appellant will be made available at the hearing. Any evidence may be received by the Hearing Officer without regard to whether that evidence could be admitted in judicial proceedings.

iii. An official record shall be made of the proceedings of every hearing. This record will be made by an official tape recording by the Division. In addition, either party may request that a verbatim transcript be made of the hearing proceedings and that such transcript shall be made the official record of the hearing. The party requesting a verbatim transcript shall pay for the transcription service, shall provide a certified copy of the transcript to the Hearing Officer free of charge, and shall allow any other party desiring to purchase a copy of the transcript to order it from the transcription service.

vi. Absence of parties.

i. If at the time scheduled for the hearing either the appellant or the agency representative is absent, and no appearance is made on behalf of such absent party, or no arrangements have been made for rescheduling the hearing, the Hearing Officer has the option to cancel the hearing unless the absent party has good cause for the failure to appear. If the Hearing Officer elects to cancel the hearing, the Hearing Officer may:

A. Treat the appeal as a record review and issue a determination based on the agency record as submitted by the agency and the hearing record developed prior to the hearing date;

B. Accept evidence into the hearing record submitted by any party present at the hearing (subject to paragraph (c)(6)(ii) of this section), and then issue a determination; or

C. Dismiss the appeal.

ii. When a hearing is canceled due to the absence of a party, the Hearing Officer will add to the hearing record any additional evidence submitted by any party present, provide a copy of such evidence to the absent party

or parties, and allow the absent party or parties 10 days to provide a response to such additional evidence for inclusion in the hearing record.

iii. Where an absent party has demonstrated good cause for the failure to appear, the Hearing Officer shall reschedule the hearing unless all parties agree to proceed without a hearing.

vii. Post-hearing procedure.

The Hearing Officer will leave the hearing record open after the hearing for 10 days, or for such other period of time as the Hearing Officer shall establish, to allow the submission of information by the appellant or the agency, to the extent necessary to respond to new facts, information, arguments, or evidence presented or raised at the hearing. Any such new information will be added by the Hearing Office to the hearing record and sent to the other party or parties by the submitter of the information. The Hearing Officer, in his or her discretion, may permit the other party or parties to respond to this post-hearing submission.

(d) *Interlocutory review*. Interlocutory review by the Director of rulings of a Hearing Officer are not permitted under the procedures of this part.

(e) *Burden of proof*. The appellant has the burden of proving that the adverse decision of the agency was erroneous by a preponderance of the evidence.

(f) *Timing of issuance of determination*. The Hearing Officer will issue a notice of the determination on the appeal to the named appellant, the authorized representative, and the agency not later than 30 days after a hearing or the closing date of the hearing record in cases in which the Hearing Officer receives additional evidence from the agency or appellant after a hearing. In the case of a record review, the Hearing Officer will issue a notice of determination within 45 days of receipt of the appellant's request for a record review. Upon the Hearing Officer's request, the Director may establish an earlier or later deadline. A notice of determination shall be accompanied by a copy of the procedures for filing a request for Director review under §11.9. If the determination is not appealed to the Director for review under §11.9, the notice provided by the Hearing Officer shall be considered to be a notice of a final determination under this part.

§ 11.9 Director review of determinations of Hearing Officers.

(a) Requests for Director review.

1. Not later than 30 days after the date on which an appellant receives the determination of a Hearing Officer under §11.8, the appellant must submit a written request, signed personally by the named appellant, to the Director to review the determination in order to be entitled to such review by the Director. Such request shall include specific reasons why the appellant believes the determination is wrong.

2. Not later than 15 business days after the date on which an agency receives the determination of a Hearing Officer under §11.8, the head of the agency may make a written request that the Director review the determination. Such request shall include specific reasons why the agency believes the determination is wrong, including citations of statutes or regulations that the agency believes the determination violates. Any such request may be made by the head of an agency only, or by a person acting in such capacity, but not by any subordinate officer of such agency.

3. A copy of a request for Director review submitted under this paragraph shall be provided simultaneously by the submitter to each party to the appeal.

(b) Notification of Parties. The Director promptly shall notify all parties of receipt of a request for review.

(c) Responses to request for Director review. Other parties to an appeal may submit written responses to a request for Director review within 5 business days from the date of receipt of a copy of the request for review.

(d) Determination of Director.

1. The Director will conduct a review of the determination of the Hearing Officer using the agency record, the hearing record, the request for review, any responses submitted under paragraph (c) of this section, and such other arguments or information as may be accepted by the Director, in order to determine whether the decision of the Hearing Officer is supported by substantial evidence. Based on such review, the Director will issue a final determination notice that upholds, reverses, or modifies the determination of the Hearing Officer. The Director's determination upon review of a Hearing Officer's decision shall be considered to be the final determination under this part and shall not be appealable. However, if the Director determines that the hearing record is inadequate or that new evidence

has been submitted, the Director may remand all or a portion of the determination to the Hearing Officer for further proceedings to complete the hearing record or, at the option of the Director, to hold a new hearing.

2. The Director will complete the review and either issue a final determination or remand the determination not later than—

   (a) 10 business days after receipt of the request for review, in the case of a request by the head of an agency; or

   (b) 30 business days after receipt of the request for review, in the case of a request by an appellant.

3. In any case or any category of cases, the Director may delegate his or her authority to conduct a review under this section to any Deputy or Assistant Directors of the Division. In any case in which such review is conducted by a Deputy or Assistant Director under authority delegated by the Director, the Deputy or Assistant Director's determination shall be considered to be the determination of the Director under this part and shall be final and not appealable.

(e) Equitable relief. In reaching a decision on an appeal, the Director shall have the authority to grant equitable relief under this part in the same manner and to the same extent as such authority is provided an agency under applicable laws and regulations.

§ 11.10 Basis for determinations.

(a) In making a determination, the Hearing Officers and the Director are not bound by previous findings of facts on which the agency's adverse decision was based.

(b) In making a determination on the appeal, Hearing Officers and the Director shall ensure that the decision is consistent with the laws and regulations of the agency, and with the generally applicable interpretations of such laws and regulations.

(c) All determinations of the Hearing Officers and the Director must be based on information from the case record, laws applicable to the matter at issue, and applicable regulations published in the Federal Register and in effect on the date of the adverse decision or the date on which the acts that gave rise to the adverse decision occurred, whichever date is appropriate under the applicable agency program laws and regulations.

§ 11.11 Reconsideration of Director determinations.

(a) Reconsideration of a determination of the Director may be requested by the appellant or the agency within 10 days of receipt of the determination. The Director will not consider any request for reconsideration that does not contain a detailed statement of a material error of fact made in the determination, or a detailed explanation of how the determination is contrary to statute or regulation, which would justify reversal or modification of the determination.

(b) The Director shall issue a notice to all parties as to whether a request for reconsideration meets the criteria in paragraph (a) of this section. If the request for

reconsideration meets such criteria, the Director shall include a copy of the request for reconsideration in the notice to the non-requesting parties to the appeal. The non-requesting parties shall have 5 days from receipt of such notice from the Director to file a response to the request for reconsideration with the Director.

(c) The Director shall issue a decision on the request for reconsideration within 5 days of receipt of responses from the non-requesting parties. If the Director's decision upon reconsideration reverses or modifies the final determination of the Director rendered under §11.9(d), the Director's decision on reconsideration will become the final determination of the Director under §11.9(d) for purposes of this part.

§ 11.12 Effective date and implementation of final determinations of the Division.

(a) On the return of a case to an agency pursuant to the final determination of the Division, the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.

(b) A final determination will be effective as of the date of filing of an application, the date of the transaction or event in question, or the date of the original adverse decision, whichever is applicable under the applicable agency program statutes or regulations.

§ 11.13 Judicial review.

(a) A final determination of the Division shall be reviewable and enforceable by any United States District Court of competent jurisdiction in accordance with chapter 7 of title 5, United States Code.

(b) An appellant may not seek judicial review of any agency adverse decision appealable under this part without receiving a final determination from the Division pursuant to the procedures of this part.

§ 11.14 Filing of appeals and computation of time.

(a) An appeal, a request for Director Review, or any other document will be considered "filed" when delivered in writing to the Division, when postmarked, or when a complete facsimile copy is received by the Division.

(b) Whenever the final date for any requirement of this part falls on a Saturday, Sunday, Federal holiday, or other day on which the Division is not open for the transaction of business during normal working hours, the time for filing will be extended to the close of business on the next working day.

(c) The time for filing an appeal, a request for Director review, or any other document expires at 5:00 p.m. local time at the office of the Division to which the filing is submitted on the last day on which such filing may be made.

§ 11.15 Participation of third parties and interested parties in Division proceedings.

In two situations, parties other than the appellant or the agency may be interested in participating in Division proceedings. In the first situation, a Division proceeding may in fact result in the adjudication of the rights of a third party, e.g., an appeal of a tenant involving a payment shared with a landlord, an appeal by one recipient of a portion of a payment shared by multiple parties, an appeal by one heir of an estate. In the second situation, a party may desire to receive notice of and perhaps participate in an appeal because of the derivative impact the appeal determination will have on that party, e.g., guaranteed lenders and reinsurance companies. The provisions in this section set forth rules for the participation of such third and interested parties.

(a) Third parties. When an appeal is filed, the Division shall notify any potential third party whose rights may be adjudicated of its right to participate as an appellant in the appeal. This includes the right to seek Director review of the Hearing Officer determination. Such third parties may be identified by the Division itself, by an agency, or by the original appellant. The Division shall issue one notice to the third party of its right to participate, and if such party declines to participate, the Division determination will be binding as to that third party as if it had participated. For purposes of this part, a third party includes any party for which a determination of the Division could lead to an agency action on implementation that would be adverse to the party thus giving such party a right to a Division appeal.

(b) Interested parties. With respect to a participant who is a borrower under a guaranteed loan or an insured under a crop insurance program, the respective guaranteed lender or reinsurance company having an interest in a participant's appeal under this part may participate in the appeal as an interested party, but such participation does not confer the status of an appellant upon the guaranteed lender or reinsurance company such that it may request Director review of a final determination of the Division.

APPENDIX 3

FORMS REFERENCED IN THIS HANDBOOK

Below is a list of forms that are mentioned in the text of this handbook. Since the Rural Development forms may change more frequently than the handbook, users are encouraged to obtain the most updated copy of these forms from the Rural Development Instructions home page (http://rdinit.usda.gov/regs) for their own reference.

Form FEMA 81-93, Standard Flood Hazard Determination
Form G-845S, Verification for SAVE Agencies
Form HUD 935.2, Affirmative Fair Housing Marketing Plan
Form RD 400-8, Compliance Review
Form RD 426-2, Property Insurance Mortgagee Clause (w/o control)
Form RD 444-27A, Amendment to RA Agreement
Form RD 1924-13, Estimate and Certificate of Actual Cost
Form RD 1944-37, Previous Participation Certification
Form RD 3550-6, Notice of Special Flood Hazards, Flood Insurance Purchase Requirements, and Availability of Federal Disaster Relief Assistance
Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance
Form RD 3560-8, Tenant Certification
Form RD 3560-9, Interest Credit and Rental Assistance Agreement
Form RD 3560-10, Borrower Balance Sheet
Form RD 3560-11, MFH Physical Inspection Report
Form RD 3560-12, Request for Authorization to Withdraw Reserve Funds
Form RD 3560-13, Management Certification
Form RD 3560-19, MFH Advice of Mortgaged Real Estate Acquired
Form RD 3560-27, Rental Assistance Agreement
Form RD 3560-29, Notice of Payment Due Report
Form RD 3560-30, No Identity of Interest Certificate
Form RD 3560-31, Identity of Interest Disclosure/Qualification Certificate
Form RD 3560-37, Previous Participation Certification
Form RD 3560-51, Obligation Fund Analysis
Form RD 3560-52, Promissory Note
Form RD 3560-53, Cancellation of U.S. Treasury Check and/or Obligation
Form RD 3560-55, MFH Transfer of RA

APPENDIX 4

HANDBOOK LETTERS REFERENCED IN THIS HANDBOOK

Handbook Letter 201 (3560), Letter of Priority Entitlement (LOPE)
Handbook Letter 202 (3560), Notification Letter for Supervisory Visit
Handbook Letter 203 (3560) Notice To Tenants (Members) Of Proposed Rent (Occupancy Charge) And Utility Allowance Change
Handbook Letter 204 (3560) Notice of Approved Rent (Occupancy Charge) and Utility Allowance Change
Handbook Letter 205 (3560) Letter to Borrowers or Management Agent
Handbook Letter 206 (3560) Letter to Tenants
Handbook Letter 207 (3560) Letter to Notify Borrower or Management Agent of a Potential Wage or Benefit Discrepancy Which Requires Review
Handbook Letter 208 (3560) Request for Renewal Rental Assistance (RA) Allocation Change

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Handbook Letter 201 (3560)

REFERENCE: HB-2-3560 Chapter 6

PURPOSE: Letter of Priority Entitlement (LOPE)

RURAL DEVELOPMENT
[*LOCATION*]

DATE: [*insert today's date*]

SUBJECT: LETTER OF PRIORITY ENTITLEMENT (LOPE) FOR:

[*insert Name of Tenant/Family*]
[*insert Tenant/Family's Address*]

Dear Tenant:

[*Suggested language for prepayment*]

The Owner(s) of [*name, address to include city, state and zip code of prepaying property*] has been granted permission to pay off their Rural Development Loan on [*name of property*]. This means that you are entitled to priority placement on the waiting list of any Rural Development Section 515 Rural Rental Housing property, should you be displaced due to of rent increases, as a result this prepayment. This letter may also serve to give you preference in non-Rural Development properties and rental programs served by the Department of Housing and Urban Development (HUD) if their occupancy policy allows. Please present this Letter of Priority Entitlement to your new landlord.

[*Or*]

As a result of the [*insert description of natural disaster, uninhabitable situation*] for the above reference property you are entitled to priority for placement on waiting lists of any 515 rural rental housing property, that has units for which you are eligible to occupy. There is no geographic limit on this entitlement. This letter may also serve to give you preference in non-Rural Development properties and rental programs served by the Department of Housing and Urban Development (HUD) if their occupancy policy allows. Please present this Letter of Priority Entitlement to your new landlord.

Dear Rural Development or Housing and Urban Development (HUD) Property Owners:

The tenant named above is currently living in the Rural Development 515 multifamily housing property for which [*insert reason for LOPE letter i.e., authorized prepayment or uninhabitable or natural disaster*]. In accordance with 7 CFR 3560.11, this letter must be used within 120 days from the above date to give this tenant/family priority placement on your waiting list(s). The only other tenants who may receive priority over this tenant/family are those who have already entered your waiting list with a letter similar to this one or handicapped tenants who need the particular design features of a vacant apartment. The above named tenant/family is to remain in this position on your waiting list until they receive an apartment or the list is purged in accordance with a Rural Development-approved policy. After 120 days, they may continue to be placed on waiting lists for apartments for which they are eligible, but without priority.

NOTE: This priority places the above-named tenant/family at the top of all waiting lists in your properties, regardless of other priorities (such as income) and eligibility's for apartment size so long as your property has at least one apartment, presently occupied or not, for which this tenant/family is eligible. If this tenant/family occupies an apartment for which size or type they are not eligible for, the lease must read that this tenant/family will move to the first appropriate apartment available.

If this tenant/family is receiving Rental Assistance (RA) at the prepaying property, they will continue to receive RA at your property if it is a property operating under Plan II of the Section 515 program. If you do not have a unit of unused RA to assign to this tenant/family, you will be allocated one unit for this purpose.

If the current security deposit is returnable to the tenant/family, but has not been released to the tenant/family by the move-in date, it should be assigned directly to you by the prepaying property if allowed by the laws of the State. Otherwise, you may have to wait to receive the security deposit until it is returned to this tenant/family.

Tenant Data:

Composition of Family _____
Tenant/Family/Elderly/Handicapped_____
Unit-Size Eligibility_____
Last Verified Income _____ as of _____
RA: _____
Section 8 Voucher: _____
Current Security Deposit: _____

If you have any questions, please contact the Servicing Office at the address below:

[*RD Servicing Official signature and title*]

Handbook Letter 202 (3560)

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Notification Letter for Supervisory Visit

RURAL DEVELOPMENT
[*LOCATION*]

Date: [*insert today's date*]

[*Name of borrower*]

[*Address of borrower*]

Dear [*insert borrower's last name(s), (Mr., Ms., Mrs.)*]

Rural Development Servicing Office staff will be conducting a supervisory visit of [*name of rural rental or cooperative project*] located in the town of [*city*].

Your project review is scheduled for [*date of visit*], at [*time*] in the project [*office or manager's office*]. We would like to meet with the project [*management agent, owner, board of directors or board president, bookkeeper, resident manager, etc.*] at the time shown.

Please have the following records available for review:

- All project account records including bookkeeper records and others pertaining to the project, such as:

  - ◊ General operating account
  - ◊ Tax and insurance escrow accounts
  - ◊ Reserve account
  - ◊ Security deposit or membership fee account
  - ◊ Patronage capital account (if applicable)
  - ◊ Management reserve account, (if applicable)
  - ◊ Checking account
  - ◊ Savings account

- The individual tenant or member files

- Waiting lists

- ◊ Applications of those on the waiting lists
- ◊ Applications of those determined ineligible for occupancy

- Management plan and management agreement/certification

- Evidence of the effort made in the last 12 months to meet the objectives in your Affirmative Fair Housing Marketing Plan.

- A copy of the tenant lease or occupancy agreement used, with written evidence of your attorney's approval, Rural Development's approval, and HUD's approval (if HUD Section 8 is utilized).

- The mailing address for the project

If you have any questions, please contact this office.

Sincerely,

[*Rural Development servicing official's signature and title*]

ENCLOSURE

Handbook Letter 203 (3560)

REFERENCE: HB-2-3560 Chapter 4

PURPOSE: Notice to Tenants (Members) of Proposed Rent (Occupancy Charge) and Utility Allowance Change

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NOTICE TO TENANTS (MEMBERS) OF PROPOSED RENT (OCCUPANCY CHARGE) AND UTILITY ALLOWANCE CHANGE

_____
Date Posted

You as a tenant (member) are hereby notified that, subject to Rural Development approval, rents (occupancy charge) and utility allowances will be changed effective _____ (at least 60 days from this posting or other timeframe if required by State law) _____ (Project Owner Name) has filed with Rural Development, United States Department of Agriculture, a request for approval of a change in the monthly rent (occupancy charge) rates and/or utility allowances of the (Name of apartment complex) for the following reasons:

1.
2.
3.
4.

Planned rent (occupancy charge) changes are as follows:

Unit Size	**Present Rent (Occupancy Charge)**		**Proposed Rent (Occupancy Charge)**		**Amount Changed**
	Basic	**Note Rate**	**Basic**	**Note Rate**	
Efficiency					
1-Bedroom					
2-Bedroom					
3-Bedroom					
4-Bedroom					
5-Bedroom					

Planned utility allowance changes are as follows:

Unit Size	Present Utility Allowance	Proposed Utility Allowance	Amount Changed
Efficiency			
1-Bedroom			
2-Bedroom			
3-Bedroom			
4-Bedroom			
5-Bedroom			

(Use where applicable such as when only basic or note rate rents and/or utility allowances are changing and the tenant is receiving rental assistance) Since you receive subsidy, your contribution for rent (occupancy charge) and utilities will not be changed so long as your income and household composition remain unchanged.

All materials justifying the proposed changes have been reviewed by Rural Development and will be made available to you and other tenants (members) to inspect and copy at (insert location): _____
during the hours of (insert date(s) and time(s)): _____.

You may submit comments or objections in writing to the Rural Development Servicing Official during the 20-day period immediately following the posting of this notice. Comments or objections should include reasons or information you feel should be considered by the Rural Development Servicing Official. Your comments or objections must be filed prior to with the Rural Development Servicing Official, _____, at the Servicing Office located at _____.

These comments will be reviewed by the Rural Development Servicing Official and forwarded to the Rural Development approval official who will decide if the change(s) should be approved.

Each tenant (member) will be notified in writing of the Rural Development decision to approve or deny the change. The approved rents and utility allowances will then be effective upon the effective date given above. If the approved change cannot be made effective by such date, an additional notice will be posted and the tenants (members) will be notified in writing that new rents (occupancy charges) and utility allowances will be effective at the next rent (occupancy charge) due date following the additional notice and the Rural Development approval.

By _____
Borrower/Borrower's Representative

Handbook Letter 204 (3560)

REFERENCE: HB-2-3560 Chapter 4 and 7

PURPOSE: Notice to Tenants of Rent Change

NOTICE OF APPROVED RENT (OCCUPANCY CHARGE) AND UTILITY ALLOWANCE CHANGE

Dear:

You are hereby notified that Rural Development has reviewed the request for a change in shelter costs for the _____ project(s), and considered all justifications provided by project management [and comments provided by tenants]. The Rural Development has approved the following rent (occupancy charge) and/or utility allowance rates listed below. The changes for all units will become effective on _____, 20__ or later effective date in accordance with state or local laws. The change is needed for the following reasons:

(Insert Reasons for Approval)

The approved changes are as follows:

Unit Size	**Present Rent (Occupancy Charge)**		**Approved Rent (Occupancy Charge)**	
	Basic	**Note Rate**	**Basic**	**Note Rate**
Efficiency				
1-Bedroom				
2-Bedroom				
3-Bedroom				
4-Bedroom				
5-Bedroom				

The approved utility allowance changes are as follows:

Unit Size	**Present Utility Allowance**	**Approved Utility Allowance**
Efficiency		
1-Bedroom		
2-Bedroom		
3-Bedroom		
4-Bedroom		
5-Bedroom		

Should you have any questions or concerns, you may contact Rural Development. The Rural Development Servicing Office address is:
(Use the following required and/or optional paragraphs where applicable).

*You must notify the tenants (members) of Rural Development's approval of the rent (occupancy charge) and utility allowance changes by posting this letter in the same manner as the "NOTICE TO TENANTS (MEMBERS) OR PROPOSED RENT (OCCUPANCY CHARGE) AND UTILITY ALLOWANCE CHANGE." This notification must be posted in a conspicuous place and cannot be substituted for the usual written notice to each individual tenant (member).

*This approval does not authorize you to violate the terms of any lease (occupancy agreement) you currently have with your tenants (members).

**For those tenants (members) receiving rental assistance (RA), their costs for rent (occupancy charge) and utilities will continue to be based on the higher of 30 percent of their adjusted monthly income or 10 percent of gross monthly income or if the household is receiving payments for public assistance from a public agency, the portion of such payments which is specifically designated by that agency to meet the household's shelter cost. If tenants are receiving Housing and Urban Development (HUD) Section 8 subsidy assistance, their costs for rent and utilities will be determined by the current HUD formula.

*You may file an appeal regarding the rate and utility allowance change as approved. An appeal must be received in the Regional Office no later than 30 calendar days after receipt of the adverse decision. The appeal should state what agency decision is being appealed and should include, if possible, a copy of the adverse decision and a brief statement of why the decision is wrong. A copy of the appeal request should be sent to the agency.

*You must inform the tenants (members) of their right to request an explanation of the rate and utility allowance change approval decision within 45 days of the date of this notice by writing to (insert the name and address of next higher Rural Development approval official). All tenants (members) are required to pay the changed amount of rent (occupancy charge) as indicated in the notice of approval.

*Any tenant who does not wish to pay the Rural Development approved rent changes may give the owner a 30-day notice that they will vacate. The tenant will suffer no penalty as a result of this decision to vacate, and will not be required to pay the changed rent. However, if the tenant later decides to remain in the unit, the tenant will be required to pay the changed rent from the effective date of the changed rent.

Sincerely,

_____
Rural Development Approving Official

*Required
**Optional, as applicable

Handbook Letter 205 (3560)

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Letter to Borrowers or Management Agents

RURAL DEVELOPMENT
[*LOCATION*]

Date: [*insert today's date*]

[*Name of borrower*]

[*Address of borrower*]

Dear[*Insert Borrower/Management Agent Name*]
[*Insert Address*]

Dear [*Insert Name*]:

Rural Development is implementing a wage and benefit matching system. The goal of the system is to find or prevent fraud, waste, and abuse of Federal benefits. We hope to achieve this goal through early detection of inaccurate information supplied on Tenant Certification Forms.

Rural Development is proud of its multi-family housing programs. Properties financed are generally well maintained and managed. Unfortunately, there are those who attempt to "beat the system" by providing inaccurate information to qualify for program benefits.

Beginning on [*Insert appropriate date*], Rural Development will have the capability to review wage and benefit information from the State Department of Labor (SDOL) for comparison with information provided on the most current Tenant Certification (Form RD 3560-8) to identify apparent inaccuracies. The Agency will be using this information to resolve discrepancies.

Should a review of SDOL data reveal a substantial discrepancy, you will have to contact the tenant household to solicit added information to explain any discrepancies, abuses, or to correct any errors. The goal is not to harass tenants but merely to resolve misunderstandings and errors as early as possible. The Agency's program will not usually look at past tenant certifications or recover any improper subsidy which may have been delivered in years past unless there is evidence of substantial abuse and the amount of the past unauthorized assistance exceeds $1,000.

Upon receipt of this notice, you should take steps to inform tenants of the wage and benefit matching initiative. You may use Handbook Letter 206 (3560) in Appendix 4 of HB-2-3560 as a guide in preparing your own tenant notification. <u>This tenant notification must be sent within 30 days from the date of this letter and a copy of this notice forwarded to this office.</u>

Any tenants that are contacted regarding discrepancies with SDOL data should be advised of their right to file a grievance under 7 CFR 3560.160 if the matter is not satisfactorily resolved. No corrective action will be initiated unless the tenant concurs with it in writing, or the timeframe for filing a grievance has passed, or the information presented in the grievance has been considered and acted upon.

The borrower or management agent will not be held responsible for repaying subsidies improperly received solely as a result of inaccurate information supplied by tenants. The borrower or management agent is expected to take corrective measures when inaccurate information is detected. The corrective measures should include prompt correction of inaccurate tenant certification forms, along with plans for tenant reimbursement for improperly delivered subsidy.

The reimbursement may be collected by lump sum or in a monthly amount added to the tenant's rent to recoup the improper subsidy.

If corrective measures cannot be achieved, tenant eviction proceedings should be promptly initiated. Tenants who falsify information and do not agree to corrective measures, or fail to uphold their subsidy repayment agreements, should be referred to the Agency along with supporting material.

In summary, the Agency's wage and benefit matching program will assist in detecting inaccuracies and dishonest actions. At the same time, the program should ensure that borrowers and management agents suffer no penalties as a result of a dishonest action on the part of others.

Sincerely,

[*Insert Name*]
[*Insert Title of Signature Official*]

Handbook Letter 206 (3560)

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Letter to Tenants

RURAL DEVELOPMENT
[*LOCATION*]

Date: [*insert today's date*]

[*Name of borrower*]

[*Address of borrower*]

Dear [Insert Tenant Name]
[*Insert Address*]

Dear [*Insert Tenant Name*]:

Rural Development is implementing a wage and benefit matching system. The goal of this system is to reduce fraud, waste, and abuse in Federal programs. This notice is to inform you about the program and how it may affect you.

Beginning on [*Insert appropriate date*], Rural Development will start receiving wage and benefit information from the State Department of Labor (SDOL). This information will be shared with the owners and management agents servicing your housing development. This information may then be compared against information provided on your Tenant Certification (Form RD 3560-8). Whenever differences are revealed, or result in the government providing unauthorized assistance in the form of rental subsidy, you may expect to be contacted for an explanation.

Rural Development assumes Tenant Certifications are completed as accurately as possible. However, misunderstandings and honest errors do occur. Unfortunately, there are also those who will report wrong information in order to qualify for Federal benefits. The objective of the record's check is to make sure that those needing assistance can receive assistance, while those who do not can be stopped and made to repay improperly received benefits.

Rural Development will implement a wage and benefit matching system fairly. Therefore, whenever a new or renewed Tenant Certification is completed, it will be subject to verification by the Agency and the owner or management agent servicing your housing development. If a problem is suspected, you will be contacted and asked to provide an explanation. If disagreements arise, you will be informed of your right to file a grievance under 7 CFR 3560.160. A copy of the grievance procedure is available from the owner or management agent servicing your housing development.

You can update or correct your existing Tenant Certification now until [*Insert date 45 days from the date the notice was received by the borrower/management agent*]. Of course, the updated and corrected Tenant Certification may result in changes to the Federal housing benefits your household is entitled to receive. However, initial changes that result in improper subsidies received by you would not be retroactive and subject to recapture if you disclose them during this grace period. Any discrepancies that result in receipt of improper assistance after this grace period ends will be subject to recapture.

If you have any further questions, please contact [*Insert contact information*].

Sincerely,

[*Insert Name*]
[*Insert Title of Signature Official*]

Handbook Letter 207 (3560)

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Letter to Notify Borrower or Management Agent of a Potential Wage or Benefit Discrepancy Which Requires Review

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RURAL DEVELOPMENT
[*LOCATION*]

Date: [*insert today's date*]

[*Name of borrower*]

[*Address of borrower*]

Dear [*Insert Borrower/Management Name*]
[*Insert Address*]

Dear [*Insert Borrower/Management Name*]:

Upon review of the attached information, we conclude that there is a discrepancy between the wages or benefits reported on Form RD 3560-8, "Tenant Certification," and those reported to [*Insert the appropriate state agency name*].

Please review this information with the tenants and provide a written explanation as to your findings and what, if any, corrective arrangements (e.g., recovery of improper benefit agreements, evictions, legal proceedings, etc.) you are making. Please provide the explanation within 30 days of the date of this letter.

Should recovery of improper payments be required, Agency regulations require collections be made by lump sum cash payment, or payment over a reasonable period of time (usually not to exceed 90 days). Whenever concerns cannot be mutually resolved, the tenants must be advised of the right to file a grievance under the provisions of 7 CFR 3560.160.

If your explanation is not satisfactory to us, we will contact you to resolve the matter. The Agency will seek a mutually satisfactory resolution. Should this not be possible, you will be formally advised of our concerns and advised of any applicable appeal rights.

If you have any questions concerning the subject matter, please contact the Servicing Office staff at [*Insert Office Telephone Number*].

Sincerely,

[*Insert Name*]
[*Insert Title of Signature Official*]

Attachments [*Attachments may include appropriate information summarizing results from the State wage information collection agency and Agency records*]

Handbook Letter 208 (3560)

REFERENCE: HB-2-3560 Chapter 9

PURPOSE: Request for Renewal Rental Assistance (RA) Allocation Change

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Date:

TO: Stephanie White
Director
Multi-Family Housing Portfolio Management Division

ATTN: Susie Turner
Fax No. 202-720-0302

SUBJECT: Request for Renewal Rental Assistance (RA) Allocation Change

Borrower's Name	Case & Project No.	No. of RA Units	Units Type
_____	_____	_____	____

ACTION REQUESTED: (Check one)

1. ___ Need to transfer ___ units from ____ quarter allocation to ____ quarter allocation due to _____
_____.

2. ___ Need to increase/decrease ___ units for the ___ quarter allocation due to
_____
_____.

3. ___ Need to transfer ____ units from O&E Code _____ to O&E Code ____.

State Director
State Office - _____

==========

[ ] APPROVED use of these funds authorized solely for the above-named borrower and may not be used for any other borrower.

[ ] DISAPPROVED due to the following reasons: _____
_____.

Please feel free to contact Susie Turner at (202) 720-1060 should you have any questions.

_____ _____

Stephanie White
Director
Multi-Family Housing Portfolio
Management Division

DATE

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APPENDIX 5

Civil Rights Laws' Accessibility Requirements That Apply to the Multi-Family Housing (MFH) Program

The Civil Rights laws covering accessibility have different implementation responsibilities but all provide for the protection and nondiscrimination of individuals with disabilities. Borrowers who fail to meet these requirements will make themselves vulnerable to damages and can be required to retrofit their facilities at their expense.

Section 504 of the Rehabilitation Act of 1973

The Department of Agriculture (USDA) implemented section 504 of the Rehabilitation Act of 1973, on June 10, 1982, by issuing 7 CFR 15b. Section 504's purpose is to assure that no otherwise qualified person with a disability is solely by reason of his or her disability excluded from benefits, or subjected to discrimination under any federally assisted program or activity.

Compliance Standard: The Uniform Federal Accessibility Standards (UFAS). For more information see www.access-board.gov/ufas/ufas-html/ufas.htm.

Highlights of section 504 Requirements

In MFH projects ready for occupancy ***on or before June 10, 1982:***

- Borrowers are encouraged to make 5 percent of the units fully accessible. (Structural changes in existing facilities may not be needed where other methods are effective in achieving program accessibility, such as reassignment of services to accessible buildings, assignment of aides to users, and delivery of services at alternate accessible sites.
  Borrowers are to use the method that provides the most integrated setting.)
- Borrowers must conduct self-evaluations and, if needed, develop transition plans. (Borrowers must make these documents available to the public or Agency upon request.)
- Borrowers must make common areas accessible when financially and structurally feasible. (Common areas include mailboxes, office, community room, trash area, playground, and laundry facilities.)
- When a qualified individual with a disability applies for admission, borrowers must make the unit accessible and usable to the individual.

In MFH projects ready for occupancy ***after June 10, 1982****:*

- 5 percent of the units, or one unit, whichever is greater, must be fully accessible.
- The mix of accessible units is to be comparable to the variety of other project units (i.e., 1, 2, and 3 bedrooms).
- All common areas must be accessible per UFAS.
- Borrowers found in non-compliance with accessibility requirements of Civil Rights laws may be required to conduct "self-evaluations" and prepare "transition plans" or respond to other administrative and legal actions.

Fair Housing Act

The Department of Housing and Urban Development (HUD) issued 24 CFR100.205 to implement the Fair Housing Act, as amended, on January 23, 1989. The Fair Housing Act requires that buildings be constructed to be accessible to individuals with disabilities.

Compliance Standard: The Fair Housing Act/Accessibility Guidelines (FHA/AG). For more information see www.hud.gov:80/library/bookshelf09/fhefhag.cfm.

Highlights of Fair Housing Act Requirements

In MFH projects ready for occupancy ***on or before March 13, 1991:***

- FHA/AG architectural requirements do not apply, even during project rehabilitation.

In MFH projects ready for occupancy ***after March 13, 1991:***

- All first floor ground units in buildings with four or more dwelling units must be designed and constructed in a manner that is adaptable to individuals with disabilities.
- All units must be adaptable if there is an elevator.
- Covered MFH projects must have:

  1. An accessible entrance on an accessible route
  2. Accessible public and common-use areas
  3. Usable doors
  4. Accessible routes into and through the dwelling unit
  5. Accessible light switches, electrical outlets, and environmental controls
  6. Reinforced bathroom walls, and
  7. Usable kitchens and bathrooms.

Americans with Disabilities Act (ADA)

The Department of Justice (DOJ) issued regulations at 28 CFR parts 35 and 36 to implement the Americans with Disabilities Act (ADA). ADA prohibits discrimination on the basis of disability in areas of public accommodations. ADA does not apply to residential units.

Compliance Standard: Americans with Disabilities Act/Accessibility Guidelines (ADA/AG). For more information see www.access-board.gov/adaag/html/adaag.htm.

Highlights of ADA requirements

In MFH projects ready for occupancy ***on or before January 26, 1993****:*

- When public areas are altered, they must be altered to ADA/AG standards. (Public areas are those areas used by individuals other than tenants and their guests. This includes offices used to pay bills or to inquire about service or employment, public restrooms, and buildings used for voting or public meetings.)

In MFH projects ready for occupancy ***after January 26, 1993:***

- Public areas must be designed and constructed to ADA/AG standards.

Grid to show MFH borrower architectural accessibility requirements of Civil Rights laws and how they affect eligibility for Agency loans.

	Section 504 Project ready for occupancy on or before 6-10-82	**Section 504** Project ready for occupancy after 6-10-82	**Fair Housing Act** Project ready for occupancy on or before 3-13-91	**Fair Housing Act** Project ready for occupancy after 3-13-91	**ADA** Project ready for occupancy on or before 1-26-93	**ADA** Project ready for occupancy on or before 1-26-93
New Construction		Must meet UFAS requirements		Must meet UFAS and FHA/AG requirements		Must meet UFAS, FHA/AG and ADA/AG requirements
Rehabilitation	1. Encouraged to meet 5% requirement 2. Must meet common area requirement, if feasible 3. Must accommodate on request 4. Must have a self-evaluation 5. If required by self-evaluation, must have a transition plan	Must meet above requirements or be addressed during rehabilitation	Not applicable	Must meet above requirements or be addressed during rehabilitation	Must meet UFAS and ADA/AG requirements or be addressed during rehabilitation (If built after 3/13/91, FHA/AG requirements apply as well)	Must meet above requirements or be addressed during rehabilitation
Equity	Prior to the receipt of equity, must meet above requirements	Must meet above requirements or be addressed prior to receipt of equity	Not applicable	Not applicable (not eligible for equity at this time)	Not applicable	Not applicable (not eligible for equity at this time)
Transfer without Rehabilitation	Prior to transfer, must meet above requirements	Must meet above requirements prior to transfer	Not applicable	Must meet above requirements prior to transfer	Not applicable	Must meet above requirements prior to transfer
Ongoing project operations – monitored by supervisory visits or compliance reviews	Must meet above requirements	Must meet above requirements and must have a self evaluation and transition plan if found in non-compliance	Not applicable	Must meet above requirements	Not applicable	Must meet above requirements

Self Evaluations and Transition Plans

On June 11, 1982, USDA issued 7 CFR 15b, which required all borrowers to conduct ***self-evaluations*** within 1 year of the USDA regulation. In the event that structural changes were necessary, recipients were required to develop ***transition plans*** that set forth the steps necessary to complete such changes.

Who must conduct self-evaluations and develop transition plans?

- Borrowers of projects ready for occupancy on or before June 10, 1982.
- Borrowers of projects ready for occupancy after June 10, 1982, where the borrower has been found in non-compliance with Civil Rights law (as a remedial action).
- Borrowers who have had complaints filed against them, and the Agency determines it is necessary.
- Borrowers transferring ownership.
- Borrowers of projects receiving rehabilitation or equity loans, when the Agency determines it necessary.
- All state and local government borrower entities. (DOJ issued a regulation on July 26, 1991, which requires all State and local governments to conduct self-evaluations, unless they had already done so to meet the requirements of section 504.)
- Borrowers receiving loans after January 1, 2001, if a self-evaluation has not been previously conducted within the last 3 years.

What standards do borrowers need to meet?

Regardless of when a project was ready for occupancy, all borrowers are required to have ***policies and practices*** that do not discriminate against persons with disabilities. The architectural ***accessibility standards*** borrowers must meet will depend on when the project was ready for occupancy and what modifications are planned. In addition, many State and local governments have their own accessibility standards that also must be met. **Rural Development does not have the authority to waive any of the accessibility requirements**. Waivers may only be granted by the Secretary of Agriculture. To date, no waivers have been granted.

What are the self-evaluation and transition plan requirements?

In accordance with 7 CFR 15b the following is required:

Self-Evaluation

(1) Evaluate, with the assistance of interested persons, including persons with disabilities or organizations representing disabled persons, its current policies and practices and the effects thereof;

(2) Modify, after consultation with interested persons, including disabled persons or organizations representing disabled persons, any policies and practices that do not meet the requirements of this part;

(3) Take, after consultation with interested persons, including disabled persons or organizations representing disabled persons, appropriate remedial steps to eliminate the effects of any discrimination that resulted from adherence to these policies and practices; and

(4) To **maintain a record** of the self-evaluation for at least three years. The record must be made available for public inspection and be provided to the Agency upon request. The self-evaluation record must contain:

(a) a list of the interested persons consulted,
(b) a description of areas examined and any problems identified, and,
(c) a description of any modifications made and of any remedial steps taken.

Transition Plans

At a minimum, transition plans are required to:

(1) Identify physical obstacles in the recipient's facilities that limit the accessibility of its program or activity to disabled persons;

(2) Describe in detail the methods that would be used to make the facilities accessible;

(3) Specify the schedule for taking the steps necessary to achieve full program accessibility and if the time period of the transition plan is longer than one year, identify steps that will be taken during each year of the transition period; and

(4) Identify the person responsible for implementation of the plan.

When structural changes are necessary, such changes shall be made within three years and as expeditiously as possible.

Examples of policies and practices to be addressed include:

- How will applicants and tenants be made aware that the owner will provide reasonable accommodations (unless doing so would cause an undue/administrative burden)?

- How will requests for reasonable accommodations be handled and who is authorized to approve or deny any such requests?

- Does the project have a Telecommunication Device for the Deaf (TDD) or an *equally effective communication syste*m? (Note: If the complex has section 8 assistance from HUD, the complex is required to have a TDD)

- If the project has a TDD, is the public made aware that there is a TDD? For example, is the TDD telephone number given each time the project's telephone number is given?

- If the project relies on a relay service as an *equally effective communication system* (rather than having a TDD), who is the relay service operated by? Is the relay service available 24 hours a day and without any added cost to the disabled person?

- Have procedures been established to accommodate hearing and sight impaired applicants and tenants. Examples of methods the borrower might use include readers, sign language interpreters, Braille, etc.

- Does management give priority for fully accessible units to persons who are in need of the special design features of an accessible unit? Is priority given first to those living in the complex and then to persons on the waiting list?

- Before accessible units are temporarily rented to people who do not need the special design features, have there been diligent marketing efforts to market the units as accessible units? Have those efforts been documented? Are lease clauses used? Do marketing efforts continue after renting the unit to someone who does not need the special design features?

- Is management's policy for verifying a person's disability limited to only that which is needed to establish eligibility and is verification required only after a tenant or applicant has asked that their disability be considered by management?

- Does management provide their employees with civil rights training?

- When marketing an elderly project, has there been an effort to reach all eligible people. Persons with disabilities (of any age) are every bit as eligible as persons who are 62 or older. Marketing efforts should be designed to reach both population groups.

- Does the recipient notify the public that they do not discriminate on the basis of disability? Do materials published by the borrower contain such a notice? Use of the Equal Housing Opportunity logo is one means of doing so (the logo is the house with the equal sign and the words Equal Housing Opportunity underneath the house).

- Does management have a policy that permits persons with disabilities to have service and/or companion animals?

- Does management give persons with disabilities the same choices other applicants are given? For example, both first and second floor apartments.

Monitoring compliance with the Self-Evaluation and Transition Plan

The Agency monitors MFH borrower compliance with Civil Rights laws through the compliance review process. Servicing Office staff who have been trained and designated will conduct the compliance review using the general format of Form RD 400-8. To assure compliance with the self-evaluation and transition plan requirements of Civil Rights laws, during the compliance review Agency staff will:

1. Visually inspect the project to determine if there are physical barriers.

2. Review the management plan to determine project management's method of informing tenants and applicants regarding requests for reasonable accommodations.

    - Visit and interview tenants to determine if the borrower has provided information and made reasonable accommodations upon request by the tenant.

3. Visit and interview tenants in the fully accessible units to determine:

    - If the tenant has need of the accessibility features of the unit and is an eligible occupant.

    - When the tenant is an ineligible occupant of the unit, if the tenant and borrower have executed a lease attachment that requires the tenant to move if an individual needing the handicapped features applies for occupancy.

4. Review the lease agreement, application and other documentation used by the borrower to determine if policies and procedures represent barriers to occupancy.

5. Review the self-evaluation plan and transition plan and compare the physical inspection to determine if there are barriers present that were not addressed or scheduled to be removed.

6. Where transition plans are scheduled to remove barriers over more than a one-year period, review the transition plan and the most recently approved budget to assure that borrower budgeting and the projects financial condition is supportive of the transition plan as written. Transition plans should include the potential cost of removing identified barriers.

The Agency's response to findings of non-compliance

When the compliance review determines the following:

- The borrower has not completed a self-evaluation when required.
- The borrower's self-evaluation does not adequately address required components.
- The borrower has not completed a transition plan when required by the self-evaluation.
- The borrower's transition plan does not adequately address required components.
- The borrower has failed to comply with their transition plan.
- The borrower is in-noncompliance with other Civil Rights law requirements.

The Servicing Office takes the following actions:

- Enter the appropriate finding under the Supervisory Activity, "Compliance Review" and provide descriptive comments on MFIS.
- Notify the borrower in writing and provide 30 days to come into compliance. The following language should be contained in your letter to the borrower regarding their con-compliance:

  > "Recent Agency monitoring of the subject project indicates that you are not currently meeting your responsibilities under applicable Civil Rights laws. Since project operating or reserve account funds may be required to address this situation, we request that you advise the Agency of how you intend to comply with the law. In addition to any penalties, liabilities, or loss of tax credits that may result from legal action brought against you by third parties, continued non-compliance may result in your ineligibility to receive further loan funds from the Agency. You failed to meet the following MFH physical standard(s) OR you are in non-compliance with the following: (Specify)"

If a borrower fails to either bring themselves into compliance within 30 days or submit an acceptable transition plan to bring themselves into compliance, the Servicing Office will notify the State Civil Rights Coordinator/Manager (SCRC/M). The State Director will forward the issue of non-compliance to the National Office Civil Rights Staff.

The National Office Civil Rights Staff will notify the State Director if further review and processing of the finding will either resolve the finding or require that it be forwarded to the USDA Civil Rights Staff or the Justice Department to resolve the non-compliance issue.

The SCRC/M will notify the State Office MFH Program Director and the Servicing Office of the disposition of the finding of non-compliance.

FREQUENTLY ASKED QUESTIONS (FAQ)
CIVIL RIGHTS-RELATED COMPLIANCE ISSUES

1. Is the International Symbol of Accessibility (ISA) required to be on a MFH project sign?

No. However, borrowers are encouraged to include the ISA on the project sign if:

- There are no physical barriers for someone wishing to inquire or apply for a service or benefit, and
- The project has an accessible route to fully accessible units.

2. Is the Telecommunication Device for the Deaf (TDD) number required to be on the project sign?

When project management communicates with hearing impaired applicants or tenants, they must use either a TTD or an "equally effective communication system." If a borrower uses a TTD number, the TTD number must be on the project sign. If a borrower uses an equally effective communication system, the borrower must document the process in their self-evaluation and let the public know how this is to be accomplished. However, the borrower is not required to post the relay service phone number on the project sign. Borrowers with Section 8/515 projects are required by HUD to use a TTD.

3. Are assistance animals that assist the disabled subject to MFH project "Pet" rules?

No. They are permitted occupancy under the Fair Housing Act and are defined as follows:

- Assistance animals are not pets. These are animals that work, provide assistance, or perform tasks for the benefit of a person with a disability, or animals that provides emotional support that alleviates one or more identified symptoms or effects of a person's disability. Assistance animals – often referred to as "service animals," "support animals," "therapy animals" or "companion animals" perform many disability-related functions including but not limited to (1) guiding individuals who are blind or have low vision, (2) alerting individuals who are deaf or hard of hearing to sounds, (3) providing minimal protection or rescue assistance, (4) pulling a wheelchair, (5) fetching items, (6) alerting persons to impending seizures, or (7) providing emotional support to persons with disabilities who have a disability-related need for such support.

- A borrower may not refuse to allow a person with a disability to have an assistance animal merely because the animal does not have formal training. Some, but not all, animals that assist persons with disabilities are professionally trained. The owners themselves train other assistance animals and, in some cases, no special training is required. The question is whether or not the animal performs the disability-related assistance or provides the disability-related benefit needed by the person with the disability.

- A borrower's refusal to modify or provide an exception to a "no pets" rule or policy to permit a person with a disability to use and live with an assistance animal would violate Section 504 of the Rehabilitation Act of 1973 and the Fair Housing Act unless:

  1. The animal poses a direct threat to the health or safety of others that cannot be reduced or eliminated by a reasonable accommodation,

  2. The animal would cause substantial physical damage to the property of others,

  3. The presence of the assistance animal would pose an undue financial and administrative burden to the provider, or

  4. The presence of the assistance animal would fundamentally alter the nature of the provider's services.

- The fact that a person has a disability does not automatically entitle him or her to an assistance animal. There must be a relationship between the person's disability and his or her need for the animal.

- A borrower may not require an applicant or tenant to pay a fee or a security deposit as a condition of allowing the applicant or tenant to keep the assistance animal. However, if the individual's assistance animal causes damage to the applicant's unit or the common areas of the dwelling, at that time, the borrower may charge the individual for the cost of repairing the damage if the provider regularly charges tenants for any damage they cause to the premises.

4. Does an applicant needing special design features have priority for occupancy over a current tenant without a need for the special design features of a fully accessible unit?

Yes. While tenants without a need for the special design features may occupy a fully accessible unit, prior to occupancy the tenant must agree to move to another unit in the project if a qualified individual needing the special design features applies for occupancy of the fully accessible unit. Borrowers are required to enter into a lease agreement with the tenant without a need for the special design features to assure that a legal right exists to require the tenant to move to another available unit in the project, when necessary.

5. What are a few suggestions to improve marketing of fully accessible units?

Before fully accessible units are rented to persons not in need of the special design features, borrowers must conduct a diligent and documented marketing effort to ensure that those in need of the special design features know about the availability for the units. Such contacts may Include, Area Commission on Aging, Physical Rehabilitation Centers, Hospitals and Disabled Veterans Organizations. Borrowers are encouraged to use the handicap accessibility logo as a marketing tool on the project sign, in advertising, and on contact letters, leaflets and brochures. When a tenant not needing the design features occupies a fully accessible unit, borrowers are to continue their marketing efforts until a tenant needing the design features is found.

6. How do borrowers meet 7 CFR 15b numerical requirements for fully accessible units?

In MFH projects ready for occupancy after June 10, 1982, 7 CFR 15b standards require:

- At least 5 percent or one unit, whichever is greater, must be fully accessible. To meet the 5 percent minimum, borrowers must round up to the next whole unit. For example, a 24-unit MFH project must have at least two fully accessible units (8.3 percent) rather than one (4.2 percent).

- Fully accessible units must be comparable in variety to other project units. For example, in a 24-unit project with 12 one-bedroom units and 12 two-bedroom units, one of the fully accessible units should be a one-bedroom unit and the other should be a two-bedroom unit.

- Rents for fully accessible units must be comparable to other same sized project units.

- If a project has more than one site, fully accessible units may not be clustered at one site, unless only one fully accessible unit is required.

- When a project has a wide variety of units (one, two, three or four bedrooms), borrowers are not required to exceed the 5 percent requirement simply to have a fully accessible unit of each type.

7. On-farm Farm Labor Housing is normally a single-family house. Is this housing subject to the 5 percent fully accessible requirement?

No. The 5 percent requirement appears in 7 CFR 15b.41. This section of the regulation only applies to multi-family rental housing. The Office of the General Counsel (OGC) provided an opinion on its application to a single unit Farm Labor Housing because 7 CFR 15b does not define "multi-family." OGC advised us that we may use the definition in Uniform Federal Accessibility Standards (UFAS), which defines multi-family housing as any "building containing more than two dwelling units." (For more information on UFAS, refer to www.access-board.gov/ufas/ufas-html/ufas.htm). Therefore, "on-farm" labor housing that consists of buildings with less than three units, is not required to meet the requirement that 5 percent of the units be constructed as fully accessible units. However, borrowers should be mindful that if a request is made for a "reasonable accommodation", that they must address accessibility at that time.

8. Who pays for reasonable accommodations?

If an eligible applicant or tenant makes a request for a reasonable accommodation, borrowers are to use project resources to complete and pay for the accommodation. A borrower may request a waiver from the Secretary of Agriculture if they can show that the modifications or other special accommodations needed by the person with a disability would cause an undue financial/administrative burden or fundamental change in operations. The borrower must prove such a burden exists in order to receive a waiver from the Secretary.

9. What type of reasonable accommodation is made?

If an eligible applicant or tenant makes a request for a reasonable accommodation, the change to be made should be based on the tenant's assessment of their needs, even when the accommodation may vary from commonly accepted accessibility standards. All improvements should be done in a professional manner and meet local building code requirements.

10. When is it appropriate to make inquiries about a person's disability?

An appropriate question for all applicants to an elderly MFH project is:

- "If you are less than 62 years old, are you eligible for occupancy based on your status as an individual with handicaps or disabilities?

Regarding the issue of adjustments to income or priority for a unit with special design features, the application form should give the opportunity to make a request for the added benefit. For example, it would be appropriate to ask all applicants and tenants:

- "Do you wish to have priority for an apartment with special design features for persons with disabilities?"

- "Do you wish to claim a $400 deduction from your income based on a disabling condition?"

By phrasing questions in this manner, applicants are advised of the benefit and allowed to decide for themselves if they wish to disclose a disabling condition. Once an applicant requests that their disability status be considered, inquires can be made, but only to the extent necessary to verify eligibility. Project management should not attempt to make any determination concerning an applicant's disabling condition.

11. May a guardian sign a rental agreement on behalf of a qualified person with a disability?

While there is no Federal law preventing a guardian from signing a rental agreement on behalf of a qualified person with disabilities, state law may vary. Each borrower should check with their legal counsel. To the extent individual state laws permit a guardian to sign a rental agreement, guardian signatures are to be accepted.

12. What are the requirements for van accessible parking?

The requirements vary based on when a project became ready for occupancy. . The parking lot of all projects with public areas such as an on-site office, ready for occupancy after January 26, 1993, must be properly striped for van accessible parking and access aisles. All projects with public areas ready for occupancy before January 26, 1993, must be striped for van accessible parking and access aisles whenever the parking lot is re-striped.

13. If accessible parking is located across the drive from the building it serves, must a crosswalk be painted on the drive?

No, it's not required. However, having a crosswalk is a good idea since it would indicate a crossing exists, and hopefully would signal a driver to slow down. There is no requirement for a painted crosswalk in the accessibility standards. Further, there is no requirement for the color of paint to be used. White is most commonly used, and sometimes blue or yellow. Curb ramps from the drive to the site are required.

14. May a borrower allow a resident assistant to occupy a unit overnight to assist a tenant with a disability?

Yes. When a tenant with a disability provides a physician's statement requiring resident assistant care in excess of the established time periods for visitors, it would be a reasonable accommodation to the rules and policies to allow the resident assistant to reside in the unit in excess of established visitor's time. Further, if the need is for the resident assistant to live in the unit, it is a reasonable accommodation to rent a two-bedroom unit to a tenant at their request. The income of a resident assistant is not included in tenant household income.

15. Is the "interested person(s)" who assists or is consulted during the borrower's preparation of their self-evaluation required to visit the project site?

No. While interested persons, including disabled persons or organizations representing disabled persons must be consulted they are not required to conduct a site visit.

16. Is the self-evaluation required to be maintained at the project site?

Yes, if the project has an office. If there is no office, the borrower is still obligated to make the self-evaluation available to the public upon request. The public includes any applicant, tenant and the Agency. It is not reasonable for the borrower to expect the public to drive to a location other than the project to view the self-evaluation.

17. What can be done with projects ready for occupancy after June 10, 1982 that were not built in accordance with UFAS standards, where it is either structurally impractical or financially infeasible to make the required changes?

Typically, the borrower should seek guidance from their project architect before making this determination. The Agency will need documentation that it is structurally impractical from a knowledgeable source. For example, in a project built using a split foyer design, it may be structurally impractical to make changes. The borrower might try to establish a referral agreement with another project in the local market area with a fully accessible unit. If no referral agreement is possible to make the program accessible, the Agency may administratively recognize that the borrower is unable to address their outstanding non-compliance issues. In this case, all avenues have been explored, and the Servicing Office will document the case file to fully explain the situation and the borrower's attempts to resolve the problem, remove the finding(s) from Multi-Family Housing Information System (MFIS) and discontinue reporting the situation through the post supervisory visit and compliance review reporting process. In some

instances, a borrower may claim that a project is not able to meet UFAS standards because the project's financial condition is such that the change would create an undue financial burden. For example, the project is located in a poor rental market and rents are insufficient to address capital needs. While the Agency has no mechanism for waiving the requirements of UFAS standards for financial reasons, the borrower may request a waiver from the Secretary of Agriculture. For such a waiver, the borrower must document the financial condition of the project as well as attempts to seek local, state, private and Federal funding for grants or loans to correct the condition.

18. Attachment C states that regardless of when a project was ready for occupancy, all borrowers are required to have "policies and practices" that do not discriminate against persons with disabilities which are provided on Attachment C-1. Where do the borrowers document these "policies and practices"?

Borrowers document these "policies and practices" in the management plan.

19. If these policies and practices are not presently covered in the management plan should we ask everybody to provide written documentation of the "policies" now or, do we wait until the management plan is renewed, or the next supervisory visit/compliance review (whichever comes first)?

We recommend that you be sure borrowers understand that these issues should be addressed in their management plans and that you will review these items in your supervisory visits, compliance reviews and management plan approvals. However, the Agency is not required to conduct a full review of all existing management plans at this time.

20. Attachment C also states that borrowers are supposed to maintain a record of the self-evaluation for at least three years. How are we going to document if they have one, if the three-year period is past?

Part V of *Form RD 400-8, Compliance Review,* should contain a record of self-evaluation status based on Agency review. While the borrower is responsible to retain records for their own protection, we can retain any self-evaluation shared with us by the borrower in our files.

21. Attachment C states that when structural changes are necessary, such changes shall be made within 3 years and as expeditiously as possible. What if major structural changes are needed and they can't be accomplished within a 3-year period?

Realistically, all structural changes should be accomplished within a three-year time frame unless funding is an issue. When changes are not made within the time frame of the transition plan, the borrower should prepare a new or revised 3-year transition plan that documents what has been done, what will be completed, and time frames for completion. Before we accept a plan, we need to be sure that the borrower is sincerely attempting to comply with the accessibility requirements. We also need to assure that rents and reserve account (RA) withdrawals are approved when necessary to make the changes.

22. Should transition plans exceed 3 years? We have seen some that just say "when funds are available." These plans are typically in projects where there is very little or no RA and rents must be kept low to keep tenants. In these cases, there may never be funds available.

Transition plans may not exceed a 3-year period and "when funds are available" is never a good time-frame. "Upon rehabilitation" is better language to use. If a poor rental market is the real issue, the transition plan should be clear that the market is the reason the borrower can not make needed improvements. If there is some way of addressing the cash flow problem (i.e., transfer RA, seek state or local grants, etc.), then the Agency should be ready to help the borrower move in that direction. This means that if a rent increase is needed, either to fund the improvement or build up the RA, the transition plan should document the amount that is needed and the Agency should be willing to approve higher rents. Also, the borrower should document their efforts to check for funding elsewhere. Some state and local governments have grant or loan funds that can be used for providing accessibility. Borrowers should be encouraged to seek out such funds if available. Once the 3 year period is completed, if corrections have not been completed, a new or revised transition plan would be required listing those incomplete items, with a proposed timeframe.

23. There are six additional items we are to review during the compliance review. Where are these items to be documented?

You will notice that some of the answers are addressed by questions already on the physical inspection form or the compliance review. While, the Civil Rights Staff has not established a separate document for the purpose of documenting this review, your assessment of the borrowers response to the six items should be documented in part V or VI of *Form RD 400-8*.

24. If we should find a borrower out of compliance with accessibility requirements and the borrower comes back with a transition plan that says they will make accommodations as needed, will the Agency be able to accept that and say that the borrower is now in compliance for tracking purposes?

Yes, however the borrower is technically out of compliance until the problem is corrected. However, if the borrower has a self-evaluation and a transition plan that describes how that particular finding will be resolved, we have established that the borrower is taking the appropriate steps to resolve their problem by establishing a timetable for corrective action in the transition plan. A good analogy is how we use our workout plan. If a workout plan is in place and being followed, the Agency can recognize that the default finding is being resolved. Therefore, we treat the project differently in our classification system.

25. Could you give us an example where time frames for compliance will be provided in Agency notices and will vary according to the nature of the non-compliance issue.

For example, according to Civil Rights Staff policy, findings on the compliance review should be corrected in 30 days. This timeframe may be expanded if conditions warrant. According to MFH program direction, supervisory visit findings can be resolved using different timeframes, generally varying from 30 to 90 days. The Servicing Office has some flexibility in providing corrective deadlines for findings found on the supervisory visit. Usually these deadlines are

established in relationship to the seriousness of the finding. Additionally, the letter to the borrower requesting corrective actions can combine findings and corrective time frames from both the compliance review and the supervisory visit.

26. Do you see any problem with the Agency keeping a copy of the self-evaluation and transition plan in the borrower's file? We initially told our field staff not to keep a copy because we didn't want the borrower to construe that as Agency approval of the documents; however, some of our field employees have asked for copies and are keeping them in the file.

It is a good idea to keep the self-evaluations and transition plans in the file because you should be reviewing them with each management plan and budget approval. Routine budget approvals should now include reviewing the transition plan to make sure that identified capital improvements are in the budget.

27. Are Agency field staff required to become “accessibility” police?

It is important to understand that since June 10, 1982, 7 CFR 15b requires the Agency to conduct compliance reviews regarding accessibility requirements. The bottom line is that the borrower is the party responsible for project compliance with accessibility laws. The Agency’s role is to assure that the program, in general, is administered in accordance with accessibility laws. We identify non-compliance during limited reviews, make project resources available to help solve problems, report problems through an internal reporting process, and respond to continued serious instances of non-compliance using established MFH program servicing tools.

28. UFAS requires that wall cabinets in accessible units be mounted at 48" above the floor. In rehabs, that has required relocating them. One owner requested mounting a separate shelf 48" above the floor, between the base and wall cabinets. Is this OK?

The Access Board has indicated that a shelf between base cabinets provides “equivalent” accessibility when it is not possible to lower wall cabinets. The shelf should not become the standard solution, but can be considered on a case-by-case basis. For example, if funds for rehabilitation are limited, the shelf may be a less expensive solution to removing and relocating wall cabinets. If funds are available, the wall cabinets should be relocated. Although deemed “equivalent,” the shelf does not have doors to cover the storage space and should not be used if relocating wall cabinets is possible.

29. Is a 30" x 34" high workspace required in an accessible dwelling unit kitchen? While UFAS 4.34.6.4 requires this, it is not included in the list in Attachment B or added to the MFH Physical Inspection Form.

Yes, it's required. The list in Attachment B was not intended to be all inclusive of UFAS standards, but to hit the big issues.

30. UFAS 4.13.9 calls for lever handles on entrance doors to accessible units. An item on the MFH Physical Inspection form asks if lever handles were provided. Does this apply to all apartment doors?

UFAS requires lever handles on apartment unit entry doors only. The question on the MFH Physical Inspection form refers to apartment unit entry doors only. If a tenant needs lever handles throughout a unit, they may be requested as a "reasonable accommodation."

31. Where are grab bars required?

Grab bars are required in the 5 percent of units that are "fully accessible." UFAS 4.34.5 uses the language "If provided, grab bars will …." Our Agency has taken the position that grab bars will be installed in order to make the "fully accessible" unit ready for a person with disabilities. Grab bars are also provided in those units in which a tenant has requested them as a "reasonable accommodation." In those ground floor units constructed since 1991, FHA/AG required blocking for "adaptability." In those units, grab bars may be installed later as a form of "reasonable accommodation" when requested.

32. How do people writing Transition Plans know to require grab bars?

Since writers of Transition Plans base them on UFAS, the proposed plan may call for installing the blocking only, and not installing the grab bars. In requiring a Self Evaluation and possibly a Transition Plan from a borrower, field staff should make them aware that the Agency has taken the position that grab bars are required in 5 percent of the units that are "fully accessible."

33. An item on the MFH Physical Inspection form refers to a "functional emergency call system." Are emergency call systems required in all fully accessible units?

If the fully accessible unit presently has an emergency call system, it must be functional. If no emergency call system is in place, the borrower does not have to provide one at this time. It may be necessary to add one as a "reasonable accommodation" per tenant request. There has been considerable confusion on this issue, and we realize that this may be a different answer than you have received in the past.

34. Is additional maneuvering room in the bathroom required?

Some Transition Plans are indicating a need to enlarge the bathroom in an accessible unit to provide a 5' turning circle, which UFAS requires in a common use bathroom. Writers of Transition Plans are incorrectly applying this requirement to a dwelling unit. Agency staff should understand that an accessible dwelling unit bathroom must have clear floor space at the tub/shower and commode, but a 5' turning circle is not required within a dwelling unit bath. Also, UFAS provides an exception in 4.22.3 for public toilets with only one lavatory and commode. In those common use toilets, a 5' turning circle is not required.

35. In addition to the requirement that 5 percent of a project's units must be fully accessible for persons with mobility impairments, is it true that MFH projects must also meet a requirement that an additional 2 percent of the units (over and above the 5 percent) must be made fully accessible by individuals with hearing or visual impairments?

To implement Section 504, both HUD and USDA individually published regulations to apply to their respective programs. While HUD's regulation does require that 2 percent of the units (over and above the 5 percent that are made fully accessible for persons with mobility impairments) be made accessible for individuals with hearing or visual impairments, USDA's regulation does not. Consequently, MFH projects with project based HUD Section 8 that were built on or after July 11, 1988, must meet this requirement, but MFH projects without project based HUD Section 8 do not. However, even when not required, borrowers are encouraged to make an additional 2 percent of the units accessible for persons with hearing or visual impairments.

36. We have an existing MFH property with multiple laundry rooms. Must each laundry room be made accessible?

Not necessarily.

- For a property constructed for first occupancy after March 13, 1991 and subject to the Fair Housing Amendments Act design requirements, laundries for the covered units must be on an accessible route, and the space must be accessible. This would apply to all ground floor laundries (or all laundries in a building with an elevator).

- In addition, for properties constructed, or with substantial alterations, after June 10, 1982, UFAS also applies. UFAS 4.1.3(3) states "Common Areas: At least one of each type of common area and amenity in each project shall be accessible and shall be located on an accessible route to any accessible dwelling unit." This sets a minimum of one accessible laundry. If accessible units are located near one another, the nearest laundry must be made accessible. If accessible units are located on opposite ends of the property, it may be necessary to make more than one laundry room accessible, depending on location and site topography. In such a situation, the nearest laundry room to each accessible unit must be made accessible.

- Regardless of when a property was constructed, it is the policy of RHS that, to the extent possible, barriers to common use areas that prevent any mobility impaired person from having full access will be removed. This does not, however, require borrowers to exceed the above standards unless it is necessary to do so in response to a request for a reasonable accommodation from a person with disabilities.

In addition, UFAS 4.34.7.2 states that washing machines and clothes dryers in common use laundry rooms shall be front loading." RHS has taken the position that this requirement is met if at least one washer and one dryer is front loading in every laundry room that is required to be accessible by UFAS. This position is taken, in part, in recognition that there may be some increase in cost to provide front loading washers and dryers.

37. If structural accessibility requirements of the Fair Housing Act were not met due to negligence of the borrower or their architect during construction, what can be done to get them corrected?

In cases where fault is established, it is a proper servicing action to seek corrections by borrowers at their own expense. To accomplish these corrections, some borrowers may in turn seek to enforce contractual agreements with project architects.

38. What are the requirements for accessibility for a community room kitchen / kitchenette?

In many situations, the requirements for an accessible dwelling unit kitchen have been applied to a common use kitchen or kitchenette. The Fair Housing Act Accessibility Guidelines and UFAS have similar requirements.

- The community room must be accessible, including an accessible route, accessible doors, switches and outlets at proper height, etc.

- The kitchen area must have an accessible sink per UFAS 4.24. This includes a mounting height no higher than 34” (or adjustable to 34”), knee clearance underneath, clear floor space at the sink, insulated piping, and an accessible faucet.

- UFAS 4.25 and 4.1.2(11) further requires that a portion of the storage provided (shelves, drawers, and cabinets) have clear floor space and be within the reach range. This requirement is normally met with standard kitchen base cabinets.

- The kitchen must have a 60” turning circle or “T” turn around for maneuverability. Space in the community room or a hallway immediately outside the kitchen may be used to meet this requirement.

- There is no requirement in a common use kitchen for an accessible work surface, range or cooktop with accessible controls, self cleaning wall oven, or an accessible refrigerator (side by side or with 50% of freezer space within reach ranges). These requirements appear in UFAS 4.34, and only apply to an accessible dwelling unit.

These requirements for a common use kitchen or kitchenette are minimums. Provision of additional accessibility in a common use kitchen or kitchenette is encouraged, but not required.

39. Can the street be utilized as part of the accessible route to an amenity? Can the disabled travel behind parked vehicles or with the traffic in the travel lane?

The accessible route may include travel behind a parked vehicle only if it is an accessible parking space. Crossing a traffic lane between curb cuts is acceptable. A striped crosswalk is not required. Otherwise, the street or traffic lane may not be part of the accessible route for an individual using a wheelchair.

If the site amenity is located at a considerable distance from the accessible unit and its accessible parking space or if site terrain is such that an accessible route along sidewalks is not possible, a vehicle can be used. This requires an accessible parking space at the site amenity, with an accessible route from that parking space to the site amenity. In this situation, the disabled individual must travel from their unit to their accessible parking space, transfer to their vehicle, drive to the site amenity, transfer back to their wheelchair, and then go to the site amenity. As you can see, this is not a convenient solution, and should be used only on existing properties in cases where no other solution is possible.