



Compliance in HOME Rental Projects:

A Guide for PJs



U.S. Department of Housing and Urban Development
Office of Community Planning and Development



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Introduction

The U.S. Department of Housing and Urban Development (HUD) and state and local jurisdictions nationwide have invested approximately \$8.7 billion in HOME Program funds in rental housing development since the program was first funded in 1992, resulting in over 330,000 units of HOME-assisted rental housing units. HOME participating jurisdictions (PJs) are responsible for seeing that HOME-assisted rental housing is affordable, its occupants are low- and very low-income, and the property is maintained in standard condition for a sustained period—known as the “affordability period.”

Because of the long-term nature of the PJ’s obligation, a sound rental compliance system must also take a long-term and broad view. Not only must PJs see that HOME-assisted projects comply with HOME regulations, PJs must also see that these rental projects remain financially, physically, and managerially viable so that they can continue to house low-income families for the duration of the affordability period. When a property fails to do this, the PJ must repay the HOME investment to HUD.

Project compliance and success is a function of good decision-making at the front end; strong rental management practices and effective monitoring with a broad perspective during the period of affordability; and early intervention at the first signs of financial difficulties.

The PJ must assert control throughout project planning and implementation phases of the project to ensure long-term compliance.

- First, the PJ must lay the foundation for compliance and project success at the earliest stage of project selection because a project that is poorly conceived or unrealistically underwritten is at-risk from the get-go.
- Once the project is selected, the PJ must create a comprehensive written agreement that enumerates all of the compliance obligations, both during implementation and ongoing occupancy.
- During the affordability period, the PJ’s monitoring must take a broad perspective to encompass regulatory compliance as well as financial, physical, and managerial viability, since these are areas where problems often emerge first.
- Once identified, PJs must proactively intervene to address financial or other difficulties before the property spirals into distress.

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- Throughout the process, the PJ's compliance system should encourage connections between the PJ's project selection process and staff and the monitoring process and staff so that the lessons learned in the ongoing monitoring of projects can inform decisions that are made about new projects.

Property owners and managers share responsibility with the PJ for compliance, as they have direct control over leasing, marketing, property maintenance, and tenant relations-- tasks that are significantly impacted by the HOME requirements for occupancy, affordability, property standards, and protection of tenant rights. The PJ's compliance system should include a proactive and ongoing technical assistance component so that property managers are well-versed in, and able to implement, these requirements.

Content and Organization of this Guide

This document, *Compliance in HOME Rental Projects: A Guide for PJs*, provides advice to PJs on how to nurture compliant HOME projects. For purposes of this guide, a compliant HOME project is a financially viable project that is maintained in standard condition and rented at affordable rents to low- and very low-income tenants, in accordance with HOME rules, for the entire period of affordability.

The guide is comprised of two parts. Part I of the guide, *Selecting and Managing HOME Rental Properties*, reviews the PJ's role in laying the foundation for a successful and compliant rental program, and reviews specific HOME regulatory requirements that directly impact rental property management functions that are carried out by the owner or a property manager: HOME income limits, rent restrictions, unit mix requirements, tenant rights, and property standards requirements. PJs can use the information in Part I to provide technical assistance to owners and property managers. Part II of the guide, *The PJ's Role in Ensuring Long-Term Compliance*, focuses on the PJ's role in monitoring during the affordability period, and the importance of PJ intervention when things go wrong.

Who Should Read this Guide?

This guide carries lessons that are important to HOME program managers, monitoring staff, underwriters and project management staff. This guide assumes that the reader understands the basic rental requirements of the HOME Program. Newcomers to the HOME Program, or readers who may need to refresh or update their knowledge of these requirements should review *Building HOME*. This training manual is available through the local HUD Field Office or on the HOME Program web page at:

www.hud.gov/offices/cpd/affordablehousing/training/materials/building/index.cfm.

HUD has issued a companion HOME model program guide entitled, *Compliance in HOME Rental Projects: A Guide for Property Owners*, that PJs can provide to property owners and managers to educate them about HOME's long-term rental compliance requirements. It is expected to be available from Community Connections, HUD's information clearinghouse in 2009. For a copy, call 1-800-998-9999.

About the HOME Program Model Guide Series

Compliance in HOME Rental Projects: A Guide for PJs is one of a number of HUD's model program guides to provide technical assistance to state and local government participating jurisdictions implementing the HOME Program. These model program guides cover a range of topics related to HOME Program administration and activities, and are available at no cost through Community Connections at 1-800-998-9999. A complete list of all the model program guides is available on the HOME Program's web page at www.hud.gov/homeprogram/.

PART I

SELECTING AND MANAGING HOME RENTAL PROPERTIES

Part I begins with a review of the PJ's role in laying the foundation for a successful and compliant rental program, through its project selection process and the written agreements it executes. Having laid the foundation, Part I then reviews specific HOME regulatory requirements that directly impact rental property management functions that are carried out by the owner or a property manager: HOME income limits, rent restrictions, unit mix requirements, tenant rights, and property standards requirements. PJs can use the information in Part I to provide technical assistance to owners and property managers. Although PJs are not directly responsible for property management functions, they must understand the ins and outs of how to manage a HOME-assisted property because:

- Property management activities (leasing, marketing and property maintenance) directly impact a property's compliance with the HOME requirements during the affordability period;
- PJs need to provide technical assistance to owners and property managers of HOME-assisted properties to be sure they know what their HOME obligations are; and
- PJs must monitor property management activities to ensure that the properties comply with HOME requirements during the affordability period.

Part I reviews the HOME requirements that apply to rental housing projects during the affordability period, and highlights decisions, issues, and concerns for PJs related to these requirements.

Chapter 1: Laying the Foundation for Long-Term Compliance

1.1. Overview

The PJ lays the foundation for long-term rental compliance at the earliest stages of project planning and selection, particularly through two key administrative activities:

- **Underwriting.** PJs have the opportunity and responsibility at the project underwriting stage to ensure that a project has the financial and managerial capacity to achieve and maintain long-term compliance and viability. The PJ's underwriting analysis should include assessing the project's ability to maintain compliance and avoid failure and repayment.
- **Written agreements and legal documents.** PJs have the responsibility to execute written agreements and subsequent legal documents that fully describe all compliance obligations. The PJ must make certain that the owner has full understanding of these compliance obligations.

This chapter reviews what underwriting is, describes how it impacts long-term project viability, and reviews lessons for sound and sustainable underwriting. The chapter further explains the importance of a strong written agreement between the PJ and the owner, with particular emphasis on why the enforcement provisions of the written agreement are important and what terms they should include.

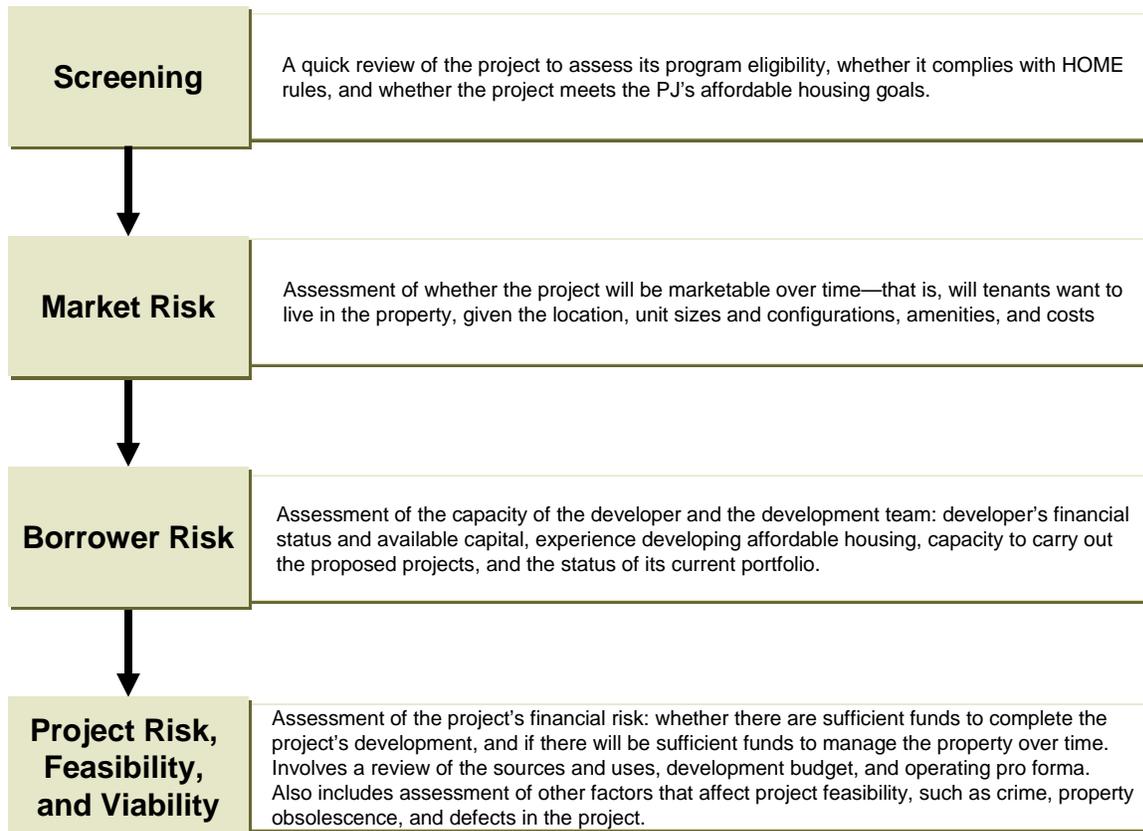
1.2. Underwriting

Through the underwriting process, the PJ assesses the market, financial, and compliance risks of a project, and decides whether or not to finance the project based on its assessment. As part of the underwriting process, the PJ often makes decisions about how to structure the project or project financing to minimize the risks it identifies. The underwriting process is extremely important to the long-term financial success of a project. Simply put, projects that are based on sound underwriting and realistic financial projections are far more likely to succeed in the long-term than those that are based on poor underwriting, or unrealistic financial projections. Even the most experienced property manager will have difficulty managing a HOME-assisted property successfully if the project is not based on sound and realistic underwriting.

1.2.A. What Is Underwriting?

The underwriting process is comprised of four key areas of review: preliminary screening of project, market risk assessment; assessment of borrower risk; and project risk, feasibility, and viability analysis. Exhibit 1-1 summarizes the key stages of the underwriting review process.

Exhibit 1-1: Key Stages of the Underwriting Review Process



While underwriting addresses elements of the project beyond compliance, the ability of the project to comply with HOME requirements is integrally related to underwriting. In particular, underwriting assesses:

- The ability of the project to achieve and maintain low-income occupancy at HOME rents and at projected occupancy levels and to maintain viability;
- The qualifications and adequacy of professional management to ensure HOME compliance and documentation; and
- The adequacy of maintenance funding and practices to ensure housing quality standards.

For more information on project underwriting, see *Financing Rental Housing under the HOME Program* (HUD-1794-CPD, January 2000). This guide is available at no cost from Community Connections at 1-800-998-9999. An updated version of this guide is forthcoming, late 2009.

1.2.B. Sustainable Underwriting

While much of underwriting focuses on the feasibility of the development plan and budget, (that is, the likelihood that the project can be implemented and occupied as proposed), the ultimate goal of underwriting is to ensure a project plan that can be sustained over the long-term. From a HOME perspective, this means at least for the minimum affordability period.

Often, PJs are under pressure to maintain or increase housing production in the jurisdiction, so they place heavy emphasis in the underwriting review on determining minimum feasibility requirements of the project, rather than

on determining what level of resources might be necessary to ensure the long-term financial viability of the project. This can result in the development of projects that are at-risk of failure in the future.

To ensure the long-term success of their portfolios of HOME-assisted housing, PJs are encouraged to undertake **sustainable underwriting**—that is, underwriting that is based on realistic financial projections to minimize risks and enhance the project’s *long-term* success.

In 2005, HUD analyzed data on actual revenue, expenses, and net operating income from a number of troubled affordable housing projects that were HOME-assisted and/or state-financed.¹ Based on its evaluation of these troubled projects, HUD identified a number of lessons for PJs to improve project underwriting. Exhibit 1-2, *Underwriting Issues that Impact Project Viability in the Long-Term*, summarizes these lessons and the following discussion explains these issues in more detail.

Exhibit 1-2: Underwriting Issues that Impact Project Viability in the Long-Term

Underwriting Assumptions	Recommendations
HOME rents and Fair Market Rents vs. market rents	When projecting rents, use rents below (10% below, if feasible) the lesser of the HOME rent limit and the market rent.
Vacancy rates	Assume a 7% vacancy and collection loss, adjusted for local market conditions.
High debt service	Assess each project individually; estimate revenues at the lower end of reasonable ranges and expenses at the higher end of reasonable ranges; and increase HOME subsidy to ensure sufficient net operating income over time, if needed.
Operating expenses and revenues	Base expense assumptions on peer properties; and trend expenses at general inflation rate, or slightly higher. Do not under-estimate maintenance costs just because a property may be new or substantially renovated.
Capital needs and reserves for replacement	Base reserve deposits on capital needs assessment for the project and update assessment periodically.

1.2.C. Issue 1: Assumptions about Future Rents: Assisted vs. Market Rents

Since rent is the primary income source to a rental property, making accurate assumptions about the rents that can be charged in a HOME project is critical to ensure that the project’s projected revenues are attainable. HOME rent limits are generally based on the HUD Fair Market Rents (FMRs) and income levels by geographic area. FMRs are gross rent estimates for the area and include shelter rent plus the cost of all tenant-paid utilities. HUD sets the FMR rent standard high enough to ensure a sufficient supply and selection of units and neighborhoods, and low enough to serve as many low-income families as possible. Currently, HUD uses the 40th percentile rent—this represents the dollar amount below which 40 percent of the standard-quality rental housing units are rented.

PJ projects, as newly developed units, are generally of higher quality than the typical rental housing in the area. This means that while the FMRs reflect the market rate for modest, existing rental housing in the area, they probably reflect below market rents for typical PJ-sponsored properties. In many housing markets, the HOME

¹ The results of HUD’s study will be published as a HOME Program model program guide in the near future. Its availability will be announced on the HOME Program web page at www.hud.gov/homeprogram/.

rents are lower than the market rents for comparable units. However, this is not always the case, and PJs must assess local housing markets individually in the underwriting process to be sure the projects they fund can realize the rents projected. Furthermore, while HOME units might initially be newer and of better quality than competing rental units, over time this advantage disappears, so it is not consistent with sustainability principles to assume a project can maintain its initial physical superiority that might justify initially higher rents.

Recommendations

1. Identify *the lesser of* the HOME rent limits (the maximum rents that can be charged) and the market rents for comparable units in the area. Adjust the rent to below that level -- at least ten percent, if feasible. This provides “room” for the rents to increase in the future, and still remain affordable to low- and very low-income tenants.
2. Set rents at a level that will result in 93 percent occupancy, or whatever level is supportable by the local market, so that there are enough target households to keep the property full.
3. Trend rents to increase over time at a rate that is below the general inflation rate and the annual rate of increases in area median incomes. When determining the rate, consider recent rent trends in the neighborhood, neighborhood trends in area median incomes, and area FMRs.

1.2.D. Issue 2: Assumptions about Vacancy Rates

The need for affordable housing in a jurisdiction does not ensure a demand for HOME-assisted housing once it is developed. HUD’s troubled project study found that many HOME-assisted properties have problems with higher than projected vacancy rates and collection losses, even though the jurisdictions have significant affordable housing needs.

High vacancy rates and collection losses can be caused by a number of factors: the rents charged may be greater than market rents in competing housing developments; the rents may be unaffordable to the occupants; the location may not be desirable; property management may not be satisfactory; and other market conditions may be at play.

Recommendations

1. Prior to making a funding commitment, secure and carefully review a market study of the proposed project to evaluate the marketability and future marketability of the project, including how realistic the proposed rents are.
2. Calculate a factor for collection loss, usually one percent or higher as rents become less affordable to the occupants.
3. Underwrite projects using a seven percent vacancy rate as a general rule of thumb, unless one of the following special circumstances exists:
 - a. If known, use the greater of seven percent or the current market level of rent loss (current vacancy rate plus one percent for bad debt); or
 - b. When rents are set well below market rents, and/or in areas with extremely competitive market conditions, use a five percent vacancy rate, but be sure conditions exist to support this level.
4. Require owners to set standards for marketing, management, and maintenance. Monitor occupancy rates and unit turnover throughout the affordability period.

1.2.E. Issue 3: Assumptions about Debt Service and Rental Income

The property's income must increase over time to pay for debt service and ever-increasing operating expenses. Many troubled projects have excessive debt service in relation to the attainable net operating income (NOI). The operating pro forma should reflect the attainable rents and realistic vacancy and collection loss assumptions, based on the PJ's evaluation of the market (discussed in Issue 2, above). If project income is over-estimated initially, or if income increases more slowly and/or expenses increase more quickly than projected, there will be disastrous consequences over time. From the sustainable underwriting perspective, vacancy and collection loss should not be set low because of initial occupancy expectations, as this will not be sustainable in the long run.

When NOI is insufficient to pay expenses and debt service, either debt accumulates and puts the property at-risk of foreclosure; or the owner pays debt service but cuts other costs by deferring maintenance to the property, or draws from replacement reserves. These short-term fixes to the cash crisis can quickly drive a project downhill. As the physical asset deteriorates, finding new tenants can become more difficult and cash flow is further curtailed.

Recommendations

1. Underwrite projects realistically but conservatively, and err on the side of underestimating rental income and overestimating expenses. Where ranges of reasonable estimates exist, take the more conservative end of the range.
2. Underwrite projects based on the needs of the specific project, and avoid hard-and-fast rules about capping the subsidy amount or providing only interest-bearing loans.
3. For projects with limited NOI, increase the HOME subsidy/investment in the project as a way to lower the project's debt service.

1.2.F. Issue 4: Assumptions about Operating Expenses

PJs should review anticipated expenses for reasonableness, and seek to lower project expenses where appropriate. However, success over the long-term depends on a healthy maintenance budget throughout the project's life; sufficient property management fees to attract a qualified and competent property manager; and adequate payments into replacement reserves, to prepare for property and major systems deterioration.

In its study of troubled projects, HUD found that actual operating expenses vary greatly from property to property, even within the same state. Traditional rules of thumb (based on either average per unit cost or a percentage of gross potential revenue) are not reliable. Given this reality, assessing project operating expenses can be difficult.

Recommendations

1. Measure controllable expenses, as compared to total expenses. Controllable expenses exclude utilities, taxes, insurance, and security.
2. Use "peer property" benchmarks as a basis of comparison for costs. "Peer properties" are properties of a similar structure type, property size, resident profile, property age, location, and average apartment size.
3. Do not under-estimate maintenance costs, even if expected repair levels might initially be low due to new components and construction warranties. Sustainable underwriting emphasizes realistic expenditures for planned maintenance to maximize the useful life of structures and systems.
4. To trend operating expenses, use a rate that is slightly higher than the general inflation rate.

1.2.G. Issue 5: Assumptions about Capital Needs and Reserves for Replacements

PJs need to pay special attention to the replacement reserves line item of the operating pro forma. For virtually all of the troubled projects studied by HUD, replacement reserves were inadequate to meet the properties' long-term capital needs. Further, it appeared that the levels of reserve deposits in these buildings were established somewhat arbitrarily. A recent capital needs assessment of the properties suggested that the properties studied will need to accumulate \$600-\$800 per unit per annum (PUPA) to address needs that will arise 15-20 years into the projects' life. However, many of these properties had accumulated as little as \$300-\$400 PUPA. As these properties age, they will need to supplement the replacement reserves with some combination of excess future cash flow, refinancing proceeds, or new government subsidy.

Recommendations

1. Be sure that operating budgets reflect sufficient funds for property maintenance, since preventive maintenance will help ensure that major systems meet their useful life.
2. Determine the appropriate level of replacement reserve by:
 - a. Securing a capital needs assessment from the owner prior to finalizing the project operating budget. A capital needs assessment of the project is the *only* way to know what the right reserve deposit is.
 - b. Requiring the owner to update the capital needs assessment periodically. This is the best early warning system available because it gives years of advance notice of impending major systems repair problems.

1.3. Legal Documents

The PJ has several tools available to hold owners legally accountable for HOME compliance: a written agreement between the PJ and the owner, a deed restriction or covenant that runs with the land, and legal documents that provide for the project financing (such as loan documents or grant agreements). Since the PJ is ultimately responsible for repaying funds to HUD if affordability is lost, the PJ must be sure that these tools provide a binding means of ensuring owner commitment and ongoing affordability.

1.3.A. Written Agreements

A PJ must execute a legally binding written agreement before it can provide HOME funds to a specific project. Effective written agreements help ensure the long-term success of the project because they:

- Articulate HOME requirements for partners and establish common expectations up-front, to minimize conflicts and confusion about roles and responsibilities during the development and rental management processes; and
- Include enforcement provisions to give the PJ the authority to intervene when necessary, to maintain project compliance and/or project viability.

1.3.B. Conveying HOME Requirements

The key purpose of the written agreement is to convey the HOME requirements to the owner. Clearly, in order to ensure there is long-term compliance in a HOME-assisted property, the owner needs to know what the requirements are. By documenting the requirements in the written agreement, the PJ minimizes the possibility that the owner either does not know what the requirements are, or does not understand the performance expectations.

The HOME Program requires that key HOME provisions are conveyed to the owner in the written agreement. The PJ is responsible for ensuring that all agreements with owners, developers, and sponsors of rental housing include the required HOME provisions that are found at 24 CFR 92.504. Additional provisions are strongly recommended to facilitate the PJ's monitoring and management of the project, and to increase its ability to enforce the terms of the agreement. Exhibit 1-3, below, summarizes the required and recommended elements of the written agreement.

Exhibit 1-3: Required and Recommended Written Agreement Provisions at 24 CFR 92.504

	Required	Recommended
Use of HOME Funds	✓	
Description of the Project		✓
Roles and Responsibilities		✓
Performance Standards		✓
Affordability (§92.252 or §92.254)	✓	
Project Requirements (as applicable in Subpart F)	✓	
Property Standards (§92.251 and §92.355)	✓	
Other Federal Requirements (Subpart H except §92.352 and §92.357)	✓	
Affirmative Marketing (§92.351)	✓	
Conflict of Interest		✓
Requests for Disbursement of Funds	✓	
Records and Reports	✓	
Monitoring		✓
Enforcement of the Agreement (§92.252, 92.254 and 24 CFR Part 85 as applicable)	✓	
Duration of the Agreement	✓	
Conditions for Religious Organizations (§92.257)	✓	
CHDO Provisions (§92.300 and §92.301)	✓	
Close-out Requirements		✓

Attachment 1-A, *Checklist for Written Agreements between the PJ and the Owner*, found at the end of this chapter, provides a detailed list of what each of these provisions includes for a HOME rental project.

In the near future, HUD expects to publish a series of guides on how to develop effective written agreement. The availability of these guides will be announced on the HOME Program web page at www.hud.gov/homeprogram/.

1.3.C. Enforcement Provisions of the Written Agreement

Long-term compliance is significantly affected by the PJ's ability to enforce the terms of the written agreement. The enforcement provisions of the written agreement establish the PJ's legal rights to intervene in a property's management when it uncovers noncompliance, or when a property is in danger of failure before it completes the period of affordability. Effective enforcement provisions:

- State the terms and conditions of enforcement clearly so that the owner understands the potential consequences of noncompliance.
- Define what constitutes a default of the agreement. The following circumstances should be included in the definition of default: noncompliance with HOME requirements described in the written agreement, use of funds for something other than the stated purpose, or material breach of the terms and/or conditions of funding.
- Establish that the PJ must notify the owner of a potential default and provide the owner an opportunity to take corrective actions. The PJ should reserve the right to take corrective actions if the owner does not.

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- State what specific actions the PJ has the right to take, in the event of noncompliance with HOME requirements, or in the event of property distress.
 - State that the owner must repay HOME funds if the HOME-assisted housing does not meet affordability requirements for the duration of the affordability period.

Note, Chapter 8, *Intervening When Things Go Wrong*, discusses specific steps that a PJ may take to intervene to address financial and compliance problems at a HOME-assisted property.

Enforcement provisions should specify the range of actions that a PJ has the right to take in the event of noncompliance or if the property is at-risk of financial failure. The provisions should give the PJ maximum flexibility to tailor the corrective actions to the severity of the circumstances.

For instance, if the PJ conducts a property inspection and a unit fails to meet the local codes and property standards, the most appropriate response may be for the PJ to direct the owner to correct the code violations within a certain period of time. However, if the owner fails to rent the HOME-assisted units to income-eligible households, the PJ should direct the owner to repay HOME funds for the project.

1.3.D. Staff Involvement in Written Agreements

PJ staff responsible for underwriting as well as those responsible for monitoring/compliance should all be involved in developing written agreements, and should be familiar with the terms of the PJ's written agreements. PJ staff should:

- Provide a sample written agreement to, and meet with, the owner early in the underwriting process to ensure that the owner understands the commitments and obligations attached to HOME funding. This helps ensure that there are no last minute surprises just before, or at, loan closing.
- Understand what the owner has committed to provide and monitor those submissions.
- Know the PJ's legal rights to monitor and enforce compliance, and to intervene when the project may be at risk.
- Meet periodically in-house to review problems at projects. Underwriting staff should share information about projects that are nearing completion, that are soon to be monitored; compliance staff should inform underwriting staff of the types of problems it uncovers. Using this information, the written agreement should be reviewed and improved periodically as well.

Amending the Written Agreement

Some PJs may have properties in their portfolios whose written agreements should be improved. PJs should amend these agreements wherever possible, to include any required provisions that may have been unintentionally omitted, and/or to strengthen the enforcement provisions before problems arise. To make amendments, PJs should follow the amendment process outlined in the written agreement. Generally, such an amendment will require concurrence by the property owner. Property owners should be willing to amend agreements in order to maintain positive relationships with the PJ. The PJ should send the HUD Field Office a copy of the amended agreement(s).

1.3.E. Deed Restrictions

HOME requires PJs to use a deed restriction, covenant running with the title to the land, or some comparable mechanism that is approved in advance by HUD to secure the HOME restrictions for the period of affordability. These legal mechanisms run with the land, and remain in effect even if the property is transferred to a new owner or the HOME loan is repaid.

In establishing these legal mechanisms, there are two important objectives:

- To record the HOME affordability commitment in the local land records so that it is disclosed to any potential or future buyer or lender; and
- To ensure that the HOME affordability commitment is senior to the mortgage debt, so that the HOME affordability commitment would survive in the event of a property transfer or refinancing.

PJs should keep in mind that the statute and regulations permit a foreclosing lender to extinguish the affordability restrictions on resale of the property. Therefore, simply recording the restrictive document does not ensure that the property will meet HUD's affordability requirements. In the event the affordability restrictions are terminated in a foreclosure during an affordability period, if the assisted units are not preserved as affordable, the PJ is responsible to repay the HOME subsidy to HUD.

1.3.F. Loan Documents

PJs execute legal agreements with property owners to provide financial assistance and secure the HOME terms and conditions, including the HOME written agreement and, frequently, a HOME loan or mortgage. These legal documents specify the terms of the financing provided and formalize the requirement to repay the HOME subsidy according to the terms of the financial commitment made by the PJ. The PJ can strengthen the enforceability of these terms by:

- Providing HOME funds as a loan, rather than a grant. Loan terms can require the owner to repay the HOME loan in the event of a default on one or more terms of the written agreement, including non-compliance. Further, the property can be used as collateral on a HOME mortgage. Loan documents should be executed and recorded separately from deed and use restrictions to ensure that, in the event funds are repaid and a loan agreement is released, the affordability restrictions will remain in place for the remainder of the affordability period;
- Specifying all the HOME affordability requirements in the loan documents; and
- Securing the highest lien position possible to maximize enforceability.

It is important to consult with legal counsel on draft documents, both to ensure that documents are legally enforceable, and to ensure that they adequately protect the PJ's interests.

Attachment 1-A: Checklist of Elements in a Written Agreement between a PJ and an Owner of Rental Housing

A PJ must execute a written agreement with each owner, developer, and sponsor of HOME-assisted rental housing before it can disburse HOME funds. PJs can use this checklist to determine whether or not their written agreements with an owner, developer, or sponsor of rental housing includes all the provisions that are required or recommended by HUD to protect the PJ's HOME investment before disbursing funds.

* Required items are denoted with an asterisk.

	Yes / No
*Provisions to Describe Use of HOME Funds	
A. HOME activity to be undertaken	
B. Project description	
1. Project address	
2. Total unit(s) and unit size(s)	
3. Special project features, such as whether or not the project involves:	
a. Land assembly and subdivision	
b. Environmental remediation	
c. Lead-based paint treatment	
d. Demolition or other site preparation	
e. Relocation	
f. Infrastructure development	
4. Number of accessible units	
5. Target population of the project (mixed-use, special needs, etc.), if any	
6. PJ-approved plans and specifications, if any	
C. Unit designations	
D. *Schedule for completing tasks	
E. *Tasks to be performed	
F. *Budget	
1. Sources and uses statement, including amount, form, use, and terms of HOME subsidy	
2. Amount and use of non-HOME funds	
3. Maximum and actual per unit HOME subsidy amount	
Provisions to Clarify Roles and Expectations	
A. Roles and responsibilities of each party	
B. Performance goals and performance standards	

**Attachment 1-2: Checklist of Elements in a Written Agreement
between a PJ and an Owner of Rental Housing** *(continued)*

	Yes / No
*Provisions to Convey Affordability Requirements of 92.252	
A. Housing must meet affordability requirements of 92.252	
B. Duration of affordability period (start and end dates; if not known, indicate how PJ will determine these dates and notify the owner/developer)	
C. *Mechanism for securing affordability (recorded deed restriction or land covenant)	
D. Number of HOME-assisted and non-assisted units in the project	
E. Whether the property has fixed or floating HOME units	
F. Number of High HOME Rent units and Low HOME Rent units that must be maintained during the affordability period	
G. HOME income limits:	
1. Guidance on how to use HOME income limits	
2. Applicable HOME income limits	
3. Income targeting (how many households at what income levels must occupy the High HOME Rent units and the Low HOME Rent units)	
4. Initial income-eligibility verification requirements and guidance, including definition of income	
5. Income certification and recertification requirements, including acceptable methods of recertifying tenant income	
6. Steps that must be taken when a tenant becomes over-income	
H. HOME rent limits:	
1. Guidance on how to use HOME rent limits	
2. Applicable HOME rent limits	
3. Initial utility allowance and guidance on use	
4. *Initial rents the owner can charge	
5. *Procedures for securing PJ approval of rent increases	
*Project Requirements	
A. Applicable requirements of Subpart F, including:	
1. Lease requirements	
2. Prohibited lease terms at 92.253(b)	
3. Termination of tenancy for cause only	
4. Tenant selection criteria required	
5. Conditions for faith-based organizations	
6. Compliance with state and local tenant-landlord laws	

**Attachment 1-2: Checklist of Elements in a Written Agreement
between a PJ and an Owner of Rental Housing (continued)**

	Yes / No
Property Standards	
A. *Applicable property standards at 92.251	
B. *Lead-based paint requirements at 24 CFR part 35 subparts A, B, J, K, M, and R	
C. *Property standards apply throughout affordability period	
*Provisions Related to Other Federal Requirements	
A. Project must be carried out in compliance with Subpart H, Other Federal Requirements, including:	
6. *Displacement, relocation, and acquisition provisions at 92.353	
7. Fair housing and equal opportunity provisions	
8. *Nondiscrimination provisions of 92.350	
9. *Labor provisions of 92.354:	
a. Davis Bacon (for projects with 12 or more units)	
b. Section 3	
c. Contract Work Hours and Safety Standards Act	
d. Anti-Kickback Act	
e. Fair Labor Standards	
10. *Conflict of interest provisions of 92.356(f)	
11. *Affirmative marketing and minority/women outreach requirements of 92.351 (for projects with five or more units)	
12. Guidelines for marketing and managing accessible units, if applicable	
Funds Disbursement	
A. When and how HOME funds can be requested	
B. *Statement that developer may not request disbursement of funds until funds are needed for payment of eligible costs	
C. *Statement that amount of disbursement request must be limited to the amount needed	
D. How often HOME funds can be requested	
E. Change order process and requirements	
F. Documentation needed to substantiate costs, including approvals for construction work, weekly payroll records, progress reports	
G. How and when costs will be paid	
H. Retainage that will be withheld and conditions under which the retainage is released	

**Attachment 1-2: Checklist of Elements in a Written Agreement
between a PJ and an Owner of Rental Housing (continued)**

	Yes / No
*CHDO Provisions if owner, developer, sponsor is a CHDO using set-aside funds	
A. *Specify applicable provisions of 92.300 and 92.301, including:	
1. CHDO proceeds- whether the CHDO retains CHDO proceeds or returns them to the PJ	
2. If CHDO retains proceeds, how they can be used	
3. Whether any funds are for project-specific technical assistance or site control loans and if so, the amount and terms of those funds	
B. Tenant participation plan	
C. Grievance procedures	
Reporting and Record-Keeping Provisions	
A. *What reports must be submitted to the PJ	
B. How often must reports be submitted	
C. Reserve right to change reporting requirements, as needed	
D. *What records must be maintained by the owner/developer/sponsor	
E. Reserve right to review records and reports by PJ, HUD, IG, etc.	
F. How long must records be retained	
G. Additional reporting or record-keeping requirements imposed by the PJ on the project	
Enforcement Provisions	
A. Reserve the right to inspect properties and units	
B. *Recorded deed restriction to secure affordability requirements	
C. Definition of breach of the agreement/default	
D. Requirements for the PJ to notify the owner/developer/sponsor of a default of the agreement, if any	
E. *Remedies or penalties for noncompliance/breach of agreement	
F. *Statement that repayment of HOME funds is required if the housing does not meet the affordability requirements for the period of affordability	

**Attachment 1-2: Checklist of Elements in a Written Agreement
between a PJ and an Owner of Rental Housing (continued)**

General Provisions	Yes / No
A. *Anti-lobbying language, as required by Consolidated Plan certifications, in accordance with 24 CFR 91.225, 91.325, and 91.425 for local governments, states, and consortia respectively	
B. *Duration of the agreement for throughout the affordability period	
C. How agreement can be cancelled without cause	
D. Whether and how the owner/developer/sponsor can assign the agreement to another party	
E. How the agreement can be modified or amended	
F. Insurance requirements imposed by PJ, such as property insurance, workers compensation, employers' liability insurance, commercial general liability insurance, risk property damage insurance	
G. PJ requirements related to project publicity	
H. Indemnification	
I. PJ approval of subcontractors	
J. Whether agreement is binding to successors and assigns	
K. Waiver of jury trial in the event of legal proceedings	
L. Form of notice, as it may be required in agreement	
M. Additional requirements imposed by the PJ on the project	

Chapter 2: HOME Income Limits

2.1. Overview

This chapter explains what the HOME income limits are and how they apply to HOME-assisted properties. Specifically, it discusses:

- What the HOME income targeting requirements are;
- What the HOME income limits are and how to use them;
- How to calculate the income limits for large families;
- How to define annual gross income;
- How to verify tenant income initially; and
- How to recertify tenant income on an annual basis during the affordability period.

2.1.A. HOME Income Limits: Summary of HOME Requirements

HUD requires that *every* HOME-assisted rental unit be occupied by a household that is low-income. For properties with five or more HOME-assisted units, HUD also requires that at least 20 percent of the units be occupied by households that are very low-income. These are the HOME **income targeting** requirements.

HUD defines a low- and very low-income household:

- **Low-income household:** The household's annual gross income is no greater than 80 percent of the area median income.
- **Very low-income household:** The household's annual gross income is no greater than 50 percent of the area median income.

The maximum amount of annual gross income that a household may earn to qualify for a HOME-assisted unit is called the **income limit**. HUD issues HOME income limits for low-income households and for very low-income households on an annual basis. The PJ must provide the updated limits to the owner.

To comply with HOME's income targeting requirements, owners/managers must determine the income-eligibility of tenants at the time of application based upon examination of **source documentation**. The PJ provides the owner/manager with the **definition of income**, which is detailed guidance on what the owner must "count" in the household's income in order to determine its annual gross income. If the tenant household's income is greater than the HOME income limit, the household cannot occupy a HOME-assisted unit.

Thereafter, owners/managers must recertify tenant household income each year during the affordability period. This must be done with source documentation every sixth year during the affordability period. In the between years, the PJ may permit the owner to use alternate forms of certification.

2.2. HOME Income Targeting

The process of designating units by income is called income targeting. The HOME income targeting requirements specify who can live in HOME units (based on income) and how much rent the tenants can pay. HUD requires that *all* HOME-assisted units be occupied by low-income households. The PJ is subject to two HOME Program income targeting requirements, for initial occupancy and for properties with more than five units:

- **Initial Occupancy.** For each annual HOME allocation that the PJ receives, at initial project lease-up at least 90 percent of the households assisted through all the PJ's rental housing programs combined must have incomes at or below 60 percent of area median income. (This includes programs for acquisition and/or development of rental housing as well as tenant-based rental assistance.) The balance of assisted households must have incomes that do not exceed 80 percent of the area median income. Because this requirement is based on all the PJ's rental housing programs, it is called "the program rule."
This initial income targeting requirement does not apply throughout the period of affordability, unless the PJ chooses to impose it for this duration.
- **Properties with Five or More HOME-Assisted Units.** For rental properties with five or more HOME-assisted units, HOME requires deeper income targeting to serve needier residents. At least 20 percent of the HOME-assisted rental units must be occupied by families who have annual gross incomes at or below 50 percent of area median income. These units must be rented at no more than the Low HOME Rents. The remaining units can be rented at no more than the High HOME Rents. Note, very low-income households may occupy High HOME Rent units and pay High HOME Rents. The HOME Rents are discussed in detail in Chapter 3.

This requirement applies throughout the period of affordability.

Owners of properties with fewer than five HOME-assisted units are not required to restrict any units to very low-income tenants or impose the Low HOME Rent.

Tips for PJs: Income Targeting

The PJ must specify in its written agreement with the property owner what income targeting requirements apply to the property—that is, how many units in the property must be rented to households at specified income levels (low-income or very low-income, or other).

Since the program rule applies to all of the PJ's rental programs, only the PJ can determine how to meet this requirement on a project-by-project basis. As a safe harbor to ensure that this requirement is met, many PJs limit the maximum income for all tenants occupying High HOME Rent units to 60 percent of area median income, at least at initial occupancy. Some PJs choose to impose this requirement throughout the affordability period.

The PJ can establish income targeting requirements that are more stringent than those established by HUD. It can do this by designating a greater number of units as Low HOME Rent units than is required by HUD, or by imposing income restrictions to reach extremely low-income households (such as those whose incomes are below 30 percent of area median income, or by using another threshold of its choosing).

The PJ might impose more stringent income targeting requirements for any number of reasons:

- If more than one funding source is invested in the property, different income targeting requirements may apply in order to comply with both sets of program rules; or
- Local policy may target assistance to tenants whose incomes are even lower than those required by the HUD limits. HUD encourages PJs to target their HOME assistance to families with the greatest housing need, or those below 30 percent of area median income.

If the PJ establishes its own income targeting requirements, it must provide the owner with guidance on what income targeting applies to the property, by household size.

2.3. HOME Low- and Very Low-Income Limits

The HOME income limits represent the *maximum* anticipated annual gross income of a household residing in a HOME-assisted unit. The HOME Program has two income limits:

- **Low-income limits.** Low-income households must have incomes that are at or below 80 percent of area median income. These limits apply to tenants that live in High HOME Rent units.
- **Very low-income limits.** Very low-income households must have incomes that are at or below 50 percent of the area median income. These limits apply to tenants that live in Low HOME Rent units.

HUD establishes HOME income limits for different localities and adjusts them for household size, from one to eight persons. When HUD issues the HOME income limits, it provides the specific maximum annual dollar amount that a low-income and very low-income household can earn in order to qualify to reside in a HOME unit.

Exhibit 2-1 provides an illustration of a HOME income limit report.

Exhibit 2-1: Sample HOME Income Limit Report

U.S. DEPARTMENT OF HUD 03/2007 STATE: DISTRICT OF COLUMBIA	----- 2007 ADJUSTED HOME INCOME LIMITS -----							
PROGRAM	1 PERSON	2 PERSON	3 PERSON	4 PERSON	5 PERSON	6 PERSON	7 PERSON	8 PERSON
Washington-Arlington-Alexandria, DC-VA-MD HUD Metro FMR Area								
30% LIMITS	19850	22700	25500	28350	30600	32900	35150	37400
VERY LOW INCOME	33100	37800	42550	47250	51050	54800	58600	62350
60% LIMITS	39720	45360	51060	56700	61260	65760	70320	74820
LOW INCOME	42000	48000	54000	60000	64800	69600	74400	79200

HUD updates the HOME income limits each year, generally in February or March. The HOME income limits are available online at www.hud.gov/homeprogram/.

Tips for PJs: HOME Income Limits

PJs have the option to use the HOME income limits as they are issued, or to impose more stringent income limits for HOME-assisted properties. If a PJ imposes its own income guidelines, it may wish to use the guidelines for households that are at or below 60 percent of area median income and 30 percent of area median income, since HUD issues these figures, for informational purposes, with the HOME income limits.

The PJ must tell owners what income limits apply to the property, and this should be documented in the written agreement between the PJ and the owner. The PJ must provide owners with the applicable HOME income limits (or locally-established income guidelines) *before* a rental property begins to lease-up, and annually thereafter, until the end of the property's affordability period. The PJ must also tell the owner that the new HOME income limits cannot be implemented by the property owner/manager until the effective date specified by HUD.

In the event that the PJ imposes its own income limits and during the affordability period the PJ's limits exceed the most recent HUD-published HOME income limits, the HOME limits apply. The PJ must communicate this guidance to the owner.

2.4. HOME Income Limits for Large Families

The HUD-published HOME income limits are adjusted for each household size from one to eight persons. For households with more than eight persons, owners/managers must calculate the income limit. This is done by adding eight percent of the four-person income limit for each additional household member. For example:

9 person household income limit = 1.40 x 4 person income limit

10 person household income limit = 1.48 x 4 person income limit

11 person household income limit = 1.56 x 4 person income limit

Attachment 4-A, *Illustration of How to Calculate Income Limits for Households with More than Eight Members*, found at the end of this chapter, illustrates how this calculation is made.

2.5. Determining Income-Eligibility

Owners/Managers must determine that a prospective tenant is income-eligible before renting a HOME-assisted unit to that household. This involves first, determining and verifying the tenant household's anticipated annual gross income; and second, comparing it to the HOME low-income limit (for a High HOME Rent unit) or very low-income limit (for a Low HOME Rent unit). If the applicant's income is greater than the HOME income limit, the household cannot occupy a HOME unit. The following sections discuss initial and subsequent income-eligibility determinations.

2.5.A. Tools for Determining Tenant Income-Eligibility

HUD has developed two tools to help owners/managers make correct tenant household income-eligibility determinations:

1. **A web-based income calculator.** Owners/Managers can use this tool to determine whether a family's anticipated annual gross income is below the applicable HOME income limit. The tool is available on HUD's HOME Program web page at: http://www.hud.gov/offices/cpd/affordable_housing/training/calculator/calculator.cfm.
2. ***Technical Guide for Determining Income and Allowances for the HOME Program: Third Edition (HUD 1780-CPD, January 2005)*.** This guide contains specific instructions on how to use each of the three definitions of annual gross income to determine tenant household income-eligibility. It includes forms to help owners/managers collect income information from tenants, verify reported income with source documents, and calculate income determinations. This guide is available at no cost from Community Connections, HUD's information service, at 800-998-9999.

Tips for PJs: Determining Tenant Income-Eligibility

The PJ must decide how to define annual gross income for purposes of determining tenant income-eligibility. The HOME Program permits the PJ to choose from one of the following three definitions of annual gross income:

1. The Section 8 Program (Part 5) definition of annual gross income; or
2. The definition of annual income as defined by the U.S. Census long form; or
3. The Internal Revenue Service (IRS) definition of adjusted gross income as defined for reporting on the IRS Form 1040. (Note: while the IRS calls this calculation "adjusted" gross income for tax purposes, it is considered "annual" gross income for purposes of the HOME Program.)

When deciding which definition to use, PJs should note that:

- The same definition of income must be used to determine initial eligibility and to recertify income in subsequent years during the affordability period;
- The same definition of income should be used for all projects within the same program activity type, but it may vary from program activity to program activity. For example, the PJ may decide to use the Part 5 definition of income for all rental housing development activities and the U.S. Census long form definition for all homebuyer activities.
- The LIHTC program uses the Part 5 definition of income. The PJ may choose to use this definition for projects with both HOME and LIHTC funds.

The PJ should specify which definition applies to a project in its written agreement with the owner. The PJ should also provide detailed written guidance to the owner about how to apply the definition.

2.5.B. Initial Income-Eligibility Determinations

Using the definition of annual gross income that is provided by the PJ, the owner/manager must determine that a household is income-eligible *before* signing a lease to rent a HOME-assisted unit. The income of *all* household members must be included, and the determination must be based on income that is expected in the next twelve months. For the initial income-eligibility determination, owners/managers must examine income source documents to verify the accuracy of the income information that the tenant reports on the application. Exhibit 2-2 identifies acceptable and unacceptable forms of source documentation.

The owner/manager determines the applicant's income-eligibility as follows:

- If the applicant will occupy a High HOME Rent unit, the household's anticipated annual gross income cannot exceed the HUD-published (or more restrictive PJ-imposed) HOME low-income limit.
- If the applicant will occupy a Low HOME Rent unit, the household's anticipated annual gross income cannot exceed the HUD-published (or more restrictive PJ-imposed) HOME very low-income limit.

Chapter 3 discusses High HOME Rent units and Low HOME Rent units.

Exhibit 2-2: Source Documentation

Acceptable source documents include:

- Wage statements for approximately the preceding 60 days, if employment is steady; or an average of the family's income for the past year, if employment is not steady or seasonal (such as construction workers or teachers);
- Interest statements;
- Unemployment compensation statements; and
- Third party verifications from employers, banks, or others with first-hand information about the applicant's finances. These verifications should be in writing, and can include documented telephone interviews.

Unacceptable source documents include:

- An applicant's income self-certification; and
- The certification from another program.

Determining Anticipated Income

The family's anticipated annual income must be based on the actual income the family receives at the time the income determination is made. The owner/manager should secure source documentation that states the family's actual current income. The owner/manager can also request that the family provide documentation of current income dated either within the 60-day period preceding the determination date or the 60-day period following the request date. When the family reports little or no income, or when the income fluctuates throughout the year, the owner/manager can review source documents and determine an average of the family's past annual income over 12 months. The owner/manager can project the actual income forward 12 months to determine the family's anticipated annual income. Annual income must include income from all family members. Income or asset enhancement from the HOME-assisted project is not considered in calculating annual income.

Duration of the Income Determination

Owners/Managers can use an applicant's income-eligibility determination for up to six months after the determination is made. If the applicant does not execute a HOME unit lease before six months have elapsed, the owner/manager must conduct a new examination of the tenant household's income-eligibility, based on a review of current source documents.

2.5.C. Tenant Income-Eligibility Recertification during the Affordability Period

Owners/Managers must examine each tenant household's income every year during the affordability period to determine if the household continues to be income-eligible to occupy its HOME-assisted unit. They must verify the income with source documentation initially and every sixth year during the affordability period, as described in Section 2.5B above. In the alternate years, tenant income must be recertified using one of three methods allowed by HUD. These methods are described in *Tips for PJs: Recertifying Tenant Income-Eligibility*, below.

Once the tenant household's anticipated annual gross income is recertified, the owner/manager must compare it to the most recent HOME income limits for the type of unit the household occupies (High or Low HOME Rent unit). If the owner recertifies a tenant's income and finds that it has increased above the HOME income limits for the type of unit it occupies, the tenant is "over-income" and the property is temporarily out of compliance. This is permissible, but the owner must take steps to restore compliance to the property. Chapter 4 discusses this further.

Tips for PJs: Recertifying Tenant Income-Eligibility

The PJ must provide the income limits to the owner at project lease-up and annually thereafter throughout the affordability period. This is important to ensure that the owner/manager uses the most recent income limits issued by HUD when making income-eligibility determinations.

Methods of Recertification

PJs must tell owners what method they must use to recertify tenant incomes. The PJ must choose from one of the following methods allowed by HUD:

- **Source documents.** Owner/Manager examines source documents to verify the tenant household's reported income. This is the method that is required upon initial occupancy and is described in Section 2.5.B, above.
- **Written statement and certification by tenant.** Owner/Manager obtains a written statement from the tenant. It must: (1) state the tenant household's annual income and household size, and (2) certify that the information provided by the tenant is complete and accurate and that the tenant will provide source documentation upon request. If the tenant's written statement fails to completely and accurately disclose information about the household's size or annual income, the owner/manager must examine source documentation for that tenant.
- **Written statement by government entity.** Owner/Manager obtains a written statement from the administrator of a government program under which the tenant receives benefits, and who examines the annual gross income of the tenant's household each year. The statement must: (1) indicate the household size, (2) provide the current income limit for the program, and (3) state that the tenant household's income does not exceed that limit.

The PJ may choose different methods of income recertification for different properties. However, the owner may not use different methods of income recertification for different tenants in the same property.

Schedule for Tenant Income Recertifications

HUD does not require that tenant income recertifications be done at any particular time in the year. However, PJs should encourage, and may wish to require, owners/managers to adopt a routine schedule for performing the annual income recertification. This schedule might be based on:

- The anniversary of the original income verification for the tenant; or
- Time of lease renewal; or
- An annual schedule whereby income recertifications for all tenant households are performed at the same time.

Over-Income Tenants

An existing tenant of a HOME-assisted unit becomes over-income when the household's income exceeds the HUD-published income limit that applies to that household's size and the type of HOME unit (High HOME Rent unit or Low HOME Rent unit) that the household occupies. The steps that owners/managers must take when a tenant is over-income are discussed in detail in Chapter 4.

If the PJ establishes income limits that are *lower* than the HUD-published income limits, an existing tenant household's income may exceed the PJ's income limits but still be income-eligible under the HOME rules. The PJ must provide guidance to the owner on what to do in this situation.

2.5.D. Recertifying Tenant Income for LIHTC Properties

To occupy a unit that was assisted with both HOME and LIHTC funds, the tenant must be determined to be income-eligible for both programs, using the income limits issued for each program. (In other words, the more restrictive income limits apply.)

2.5.E. Recertifying Tenant Income for Persons with Disabilities

In general, owners/managers recertify the incomes of tenant households that include a person with a disability in the same way that they recertify other tenant household incomes. However, when a tenant with a disability was previously unemployed, and his or her family's household income increases because the person with a disability becomes employed or participates in a self-sufficiency program, a special exception applies. When recertifying the income of such a household, the owner/manager can exclude all the income earned by the person with a disability in the first year; and exclude half of the income earned in the second year. These exceptions apply regardless of which definition of annual gross income is used.

Additional guidance to implement this exclusion can be found at 24 CFR 5.617. Note, *previously unemployed* is defined as having “earned, the twelve months previous employment, no more than would be received for 10 hours of work per week for 50 weeks at the established minimum wage.”

Attachment 2-A: Illustration of How to Calculate the Income Limit for Households with More than Eight Members

Scenario: The property manager needs to determine the income-eligibility of a nine-person household that will occupy a High HOME Rent unit.

Step 1. Identify the starting points.

- The percentage increase allowed by HUD for each additional bedroom is 8 percent.
- The HUD-published four-person low-income limit for the area is \$35,600.

Step 2. Determine by how many people in the household exceed the 4-person household.

$$9 \text{ persons} - 4 \text{ persons} = 5 \text{ persons}$$

Step 3. Multiply 8 percent by the number of additional people over the 4-person household.

$$\begin{aligned} .08 \times 5 &= .4 \text{ (40\%)} \\ &\text{or} \\ 8\% \times 5 &= 40\% \end{aligned}$$

Step 4. Add this percentage to 100 percent and convert to a decimal.

$$40\% + 100\% = 140\%, \text{ or } 1.4$$

Step 5. Multiply the decimal percentage (from Step 4) by the HUD-published four-person income limit for the area.

$$1.40 \times \$35,600 = \$49,840$$

\$49,840 is the low-income limit for a 9-person household.

Note, if the 9-person household will occupy a Low HOME Rent unit, the family's household income cannot exceed the very low-income limit. The owner/ manager follows the same steps using the HUD-published very low-income limit for a family of four.

Chapter 3: HOME Rent Restrictions

3.1. Overview

This chapter discusses the HOME rent restrictions that apply to HOME-assisted units to keep the units affordable. Specifically, this section provides guidance on:

- Using the High HOME rent limits and Low HOME rent limits;
- Determining the HOME rent limits for units with more than six bedrooms;
- Determining maximum rents that can be charged when tenants pay for utilities; and
- Determining HOME rent limits for special types of HOME properties, including projects with Federal or state project-based subsidies, single-room occupancy housing, group homes, and projects with Low-Income Housing Tax Credits.

3.1.A. HOME Rent Limits: Summary of HOME Requirements:

HUD requires that the rents that are charged for HOME-assisted units be affordable to low- and very low-income households. HUD provides **HOME rent limits** to define what is affordable.

High HOME rent limits are the maximum rents that can be charged to low-income households. These are based on the *lesser of*:

- The Section 8 Fair Market Rents (FMRs) for existing housing; or

Thirty percent of the adjusted income of a family whose annual income equals 65 percent of area median income.

Low HOME rent limits are the maximum rents that can be charged to very low-income households that must reside in at least 20 percent of the units in properties with more than five HOME-assisted units. These are based on one of the following:

- Thirty percent of the tenant's monthly adjusted income; or
- Thirty percent of the annual income of a family whose income equals 50 percent of area median income (the HUD-issued Low HOME Rent); or
- If a property has a Federal or state project-based rental subsidy and the very low-income tenant pays no more than 30 percent of his or her adjusted income toward rent, the maximum rent allowable under the project-based rental subsidy program. (See Section 3.4.A for discussion of HOME rent limits in properties with rental subsidies.)

The HUD-published HOME rent limits include utilities. When a tenant pays directly for utilities, the owner/manager must subtract a PJ-approved **utility allowance** to determine the maximum rent that can be charged for the unit.

HUD updates the HOME rent limits every year. If the rent limits go up and utility costs remain steady, the owner can raise rents accordingly. If the HOME rent limits go down or the utility costs go up, the owner may be required to decrease rents. The owner is never required to decrease rents below the initial rents approved by the PJ at the time of project commitment, although market conditions may make it necessary to do so. Rent adjustments must be made in accordance with the tenant's lease.

The PJ must approve all rent schedules for a property prior to lease-up. The PJ must also approve all rent increases during the affordability period.

3.2. High and Low HOME Rent Limits

The HOME rent limits are the *maximum* rents that can be charged to an income-eligible tenant residing in HOME-assisted unit. The HOME Program has two rent limits: the High HOME rent limits and the Low HOME rent limits. The HOME rent limits include utilities. This means that the owner/manager must deduct tenant-paid utilities from the published HOME rents, to determine the maximum rents that can be charged for a HOME-assisted unit. See Section 3.2.E to determine the maximum rents in properties where the tenants pay their own utilities.

The HUD-issued HOME rent limits are adjusted for different localities and for each bedroom-size unit from zero (efficiency) to six bedrooms.

3.2.A. High HOME Rent Limits

HUD determines the High HOME Rent limits and issues them annually. The HOME Rent limits are based on the lesser of:

- The Section 8 Fair Market Rents (FMRs) for existing housing; or
 - Thirty percent of the adjusted income of a family whose annual income equals 65 percent of median income.
- High HOME Rents apply to units that are High HOME Rent units, and are occupied by low-income tenants.

3.2.B. Low HOME Rent Limits

The Low HOME Rent limits are based on one of the following:

- Thirty percent of the tenant's monthly adjusted income; or
- Thirty percent of the annual income of a family whose income equals 50 percent of median income (these are identified as the Low HOME Rent limits when HUD issues the HOME rent limits); or
- If a unit has a Federal or state project-based rental subsidy and the very low-income tenant pays no more than 30 percent of his or her adjusted income toward rent, the rent allowable under the project-based rental subsidy program. Section 3.4.A discusses HOME rent limits in properties with project-based rental subsidies.

The PJ determines which Low HOME rent limits apply at a property. Low HOME Rents apply to at least 20 percent of the units in properties with five or more HOME-assisted units that are occupied by very low-income tenants. These are called "Low HOME Rent units."

Exhibit 3-1 provides an example of HUD's published HOME rent limits.

Exhibit 3-1: Sample HOME Rent Limit Report

U.S. DEPARTMENT OF HUD 03/2007 STATE: DISTRICT OF COLUMBIA		----- 2007 HOME PROGRAM RENTS -----					
PROGRAM	EFFICIENCY	1 BR.	2 BR.	3 BR.	4 BR.	5 BR.	6 BR.
Washington-Arlington-Alexandria, DC-VA-MD HUD Metro FMR Area							
LOW HOME RENT LIMIT	827	886	1063	1228	1370	1511	1653
HIGH HOME RENT LIMIT	995	1086	1286	1500	1654	1806	1959
For Information Only:							
FAIR MARKET RENT	995	1134	1286	1659	2171	2497	2822
50% RENT LIMIT	827	886	1063	1228	1370	1511	1653
65% RENT LIMIT	1013	1086	1306	1500	1654	1806	1959

Tips for PJs: HOME Rent Limits

Locally-Imposed Rent Limits

The PJ can choose to use the HUD-issued HOME rent limits or it can establish rent limits that are *lower* than the High HOME rent limits and Low HOME rent limits that are published by HUD. For example, the PJ might choose to cap the amount of rent that extremely low-income tenants must pay. However, the PJ cannot establish rent limits that are higher than the High or Low HOME Rent limits that are published by HUD.

PJ Notification of Applicable Rent Limits

The PJ must provide the applicable rent limits (either the HUD-issued HOME rent limits or the locally-imposed ones) to the property owner before the property begins to lease up. It must provide updated rent limits on an annual basis throughout the property's affordability period. HUD updates and publishes HOME rent limits each year, generally in February or March. The HUD-published HOME rent limits are available at www.hud.gov/homeprogram/.

The PJ determines which of the three Low HOME Rent options is used in a HOME-assisted property. Most PJs use the HUD-published Low HOME Rents (based on 30 percent of the adjusted income of a very low-income family), or the project-based rent limits for properties that have project-based rental assistance. Very few PJs require owners/managers to base Low HOME rents on 30 percent of the tenant household's adjusted income. This is because it is very difficult to underwrite projects and make sound financial projections based on rental income to the property that will vary depending on specific tenant household incomes.

In the event the PJ uses a locally-imposed rent limit and during the affordability period the PJ's limit exceeds the HOME rent limits, the PJ must notify the owner that the lower HOME rent limit applies.

PJ Unit Designations

When a property is assisted with HOME funds, the PJ must identify which units are designated HOME-assisted and which units are designated non-assisted. Further, in properties with five or more HOME-assisted units, the PJ must designate at least 20 percent of the HOME-assisted units as Low HOME Rent units, for very low-income occupants. The remaining units (as many as 80 percent) would be High HOME Rent units. In properties with fewer than five HOME-assisted units, HUD permits the PJ to designate all the HOME-assisted units (100 percent) as High HOME Rent units, but the PJ can choose to designate some or all of the units as Low HOME Rent units, if it chooses.

The PJ's designation of units as HOME-assisted or non-assisted, or as High HOME Rent units or Low HOME Rent units, are the "unit designations." These concepts are discussed further in Chapter 4.

The PJ should include specific unit designation information in the written agreement between the PJ and the owner.

3.2.C. Rent Limits for Large Units

The HUD-published HOME rent limits are adjusted for each bedroom size unit from zero bedrooms (efficiency) to six bedrooms. For units with seven or more bedrooms, owners/managers must calculate the rent limit.

This is done by adding fifteen percent of the four-bedroom rent limit for each additional bedroom. For example:

$$7 \text{ bedroom rent limit} = 1.45 \times 4 \text{ bedroom rent limit}$$

$$8 \text{ bedroom rent limit} = 1.60 \times 4 \text{ bedroom rent limit}$$

Attachment 5-A, *Illustration of How to Calculate HOME Rents for Units with More than Six Bedrooms*, found at the end of this chapter, provides an illustration of how this calculation is made.

3.2.D. Rent Limits for Tenants Receiving Section 8 or Tenant-Based Rental Assistance

When a household receives *tenant-based* rental assistance (TBRA) provided by the Section 8 Program, HOME, or another funding source, the maximum allowable rent for the HOME-assisted unit cannot exceed the applicable HUD-published HOME rent limit. This means that the tenant's rental assistance payment *plus* the tenant's contribution towards rent cannot exceed the HUD-published High HOME rent limit for a High HOME Rent unit or the Low HOME rent limit for a Low HOME Rent unit.

Rents charged to tenants with TBRA (subsidy plus tenant contribution) must be the same as the rents charged to other tenants for comparable units. The Section 8 rules specifically prohibit an owner from charging a higher rent for a unit that is occupied by a voucher holder than the rent charged for a comparable unit not occupied by a voucher holder. This means that if the owner charges less than the maximum HOME rent for HOME units that are not occupied by vouchers holders, it can only charge that rent to the voucher holder.

For example, the tenant of a Low HOME Rent unit receives HOME TBRA. Under the PJ's guidelines, the family contributes 30 percent of its income toward rent, which is \$750/month. The Low HOME Rent for the unit is \$880/month. This is generally considered market rate for the area. Therefore, the maximum rent the owner can receive in TBRA is \$130 (\$880 - \$750).

3.2.E. Rent Limits When the Tenant Pays Utilities or Other Fees

The HUD-published HOME rent limits include utilities. This means that when a tenant pays directly for utilities, the owner/manager must subtract a PJ-approved utility allowance from the applicable HUD-published HOME rent limits, in order to determine the maximum rent that it can charge for the HOME-assisted unit.

Attachment 5-B, *Determining Rents for Units with Tenant-Paid Utilities*, found at the end of this chapter, includes a sample utility allowance chart and illustrates how owners should use it to deduct utility allowances in order to determine the maximum rents that can be charged.

Fees and Other Surcharges

Mandatory fees and services are not encouraged in HOME projects, and are subject to a PJ's written approval before they can be imposed on a tenant. Generally, if imposed, HUD requires the owner to deduct all mandatory fees from the HOME rent limit to determine the maximum rent that can be charged for a unit. PJs should consult with the local HUD field office for guidance on mandatory fees on a project-by-project basis.

Tips for PJs: Utility Allowances and Other Fees

Establishing a Utility Allowance

The PJ establishes the utility allowance and must provide it to owners/managers before a rental property begins to lease-up. The PJ must update the utility allowance and provide it to the owner on at least an annual basis throughout affordability period.

The utility allowance represents the average monthly cost for utilities and services, excluding telephone. The PJ can base the utility allowance on:

- The utility allowance schedule that is established by the local public housing agency for the Housing Choice Voucher Program (Section 8);
- The PJ's own methodology; or
- Project-specific information.

PJs may wish to develop and use project-specific utility allowances in situations where the project's actual utility costs differ greatly from the average utility costs in the area, such as in properties with energy efficiency features. Further, for ease of administration, the PJ may choose to adopt the LIHTC utility allowance for HOME-LIHTC projects in its portfolio, since the LIHTC program may use a different utility allowance than the HOME Program. See Section 3.4.B, below, for a discussion of LIHTC utility allowances.

Fees and Other Charges

With the PJ's written permission, owners are permitted to charge additional fees only if they are reasonable and customary to the housing market, such as fees for parking.

3.3. PJ Approval for Rent Adjustments

The PJ must approve the property's rent structure at project lease-up, and must approve all rent increases during the affordability period.

- Rent increases might occur when:
 - HUD-published High HOME rent limits and Low HOME rent limits increase;
 - The tenant pays utilities and the PJ's utility allowances decrease; or
 - The tenant becomes over-income.
- Rent decreases might occur when:
 - The HUD-published HOME rent limits decrease; or
 - If the tenant pays utilities and the utility allowance increases more than the HUD-published HOME rent limits.

Owners/Managers are never required to charge rents that are lower than the HOME rent limits that were in effect at the time that the PJ made its initial commitment of HOME funds to that HOME property. Any changes in rents for occupied units are subject to the terms of the tenant's lease. Rent adjustments for over-income tenants are discussed in Chapter 4.

Tips for PJs: Approving Rents and Making Rent Adjustments

Approving Rents

The purpose of the PJ's review of a property's rent structure is to determine that:

- The rents comply with the HOME rent limits; and
- Rents are reasonable, given the PJ's knowledge of the local housing market.

The PJ's written agreement with the owner should specify the initial rent structure and the procedures for PJ approval of subsequent rent increases.

Exceptions to the HOME Rent Limits

In the case of *extreme* financial hardship, the PJ can ask HUD to increase the rent limits for a particular property in order to maintain the property's financial viability. HUD uses this authority for a rent exception sparingly, however. Rent exceptions are only made for existing properties that are suffering severe financial hardships, and when all other reasonable steps to restore financial viability to the property have been exhausted. See Chapter 8 for a discussion of how the PJ can intervene when a property begins to decline.

3.4. HOME Rent Limits for Special Types of HOME Units

For certain types of properties, the HOME rent limits vary from the general guidance provided previously in this chapter. Exhibit 3-2, below, summarizes these situations.

Exhibit 3-2: Summary of HOME Requirements: Special Types of Units

For certain types of properties, the HOME rent limits vary from the general guidance provided in Section 3.3 of this chapter, as follows:		
	Low HOME Rent Limit	High HOME Rent Limit
Units with state or Federal project-based rental assistance	The project-based rent may be charged for any unit that: <ol style="list-style-type: none"> 1. Receives state or Federal project-based rental assistance; 2. Is occupied by a very low-income tenant; and 3. The tenant household pays no more than 30% of its adjusted monthly income toward rent. 	The <i>lesser of</i> the project-based rent or the High HOME Rent may be charged when the tenant household either: <ol style="list-style-type: none"> 1. Is low-income, but not very low-income, or 2. Pays more than 30% of its income towards rent.
Units with LIHTC assistance	Capped at the <i>lesser of</i> the Low HOME rent limit or the LIHTC rent limit for that unit.	Capped at the <i>lesser of</i> the High HOME rent limit or the LIHTC rent limit for that unit.
Group homes	Does not apply because a group home is considered a single unit under the HOME Program.	Rent is based on the rent of a single unit with multiple bedrooms. Capped the HUD-published Fair Market Rent (FMR).
SRO housing	The Low HOME Rent that is used depends on (1) whether the unit has food preparation and/or sanitary facilities, and (2) if the unit has state or Federal project-based assistance. Note, for all SRO projects with five or more units, at least 20% of the units must be occupied by very low-income households. See Exhibit 3-4 for details.	The High HOME Rent that is used depends on (1) whether the unit has food preparation and/or sanitary facilities, and (2) if the unit has state or Federal project-based assistance. See Exhibit 3-4 for details.

3.4.A. Setting Rents for Units Receiving State or Federal Project-Based Rental Assistance

Any unit with a project-based subsidy is a Low HOME Rent unit when it is occupied by a very low-income tenant who pays no more than 30 percent of its adjusted gross income for rent.

If an owner recertifies the tenant household's income and determines that it has increased over the very low-income limit, the unit no longer qualifies as a Low HOME Rent unit. The owner must re-designate the unit as a High HOME Rent unit. The rent can be adjusted up to no more than the High HOME Rent. This is typically less than the project-based assistance rent. The portion of rent charged to the tenant is still 30 percent of the tenant's (now greater) adjusted income, in accordance with the rules of the project-based rental assistance program. The rent to the owner will change, and will be based on the difference between High HOME Rent minus the tenant's rent contribution. Exhibit 3-3 illustrates this concept.

Exhibit 3-3: Illustration of How to Adjust Rents when a Tenant in a Project-Based Unit Goes Over-Income

In ABC Town, the following income and rent limits apply:

Income limits for a 4-person household

- Very low-income: \$25,850
- Low-income: \$31,020

Rent Limits for a 3-bedroom unit

- Low HOME Rent: \$671
- High HOME Rent: \$840
- Project-Based Rents: \$870

The Nimble Family has 4 members. It occupies a 3-bedroom HOME-assisted unit in a property with Section 8 project-based subsidies. When the family initially moved in, the household annual income was \$24,500. Because the household was very low-income, they were rented a Low HOME Rent unit. The PJ permitted the owner to charge the project-based rent, or \$870. The Nimbles paid 30% of their income for rent, or \$612/month ($\$24,500/12 \times .30$). The project-based subsidy paid the remaining \$258/month to the owner.

When the owner recertified the Nimble's household income, it found that Mr. Nimble received a raise at work and the household income had increased to \$27,000. The family is low-income, but no longer qualifies as very low-income. When a substitute Low HOME Rent unit has been designated in the property, the owner must redesignate the Nimble's unit as a High HOME Rent unit and adjust the rent accordingly. Now, the owner can charge no more than the lesser of the High HOME Rent (\$840) or the project-based rent (\$870), or \$840/month. The Nimble's contribution toward rent needs to be adjusted to reflect 30% of its new income, or \$675/month ($\$27,000/12 \times .30$). The project-based subsidy will now pay the remaining \$165 to the owner ($\$840 - \675).

Tips for PJs: Establishing Low HOME Rents for Units with Project-Based Subsidies

The PJ has two options for establishing the Low HOME rent limits for units with project-based subsidies:

1. The PJ can require the owner/manager to charge rents that do not exceed the *lesser of* the state or Federal project-based rent limit or the HUD-published Low HOME rent limit (minus the PJ-approved utility allowance, when applicable); or
2. The PJ can authorize the owner/manager to use the state or Federal project-based rent limit.

The PJ determines which rents apply and must provide owners/managers with specific guidance on how to determine rents. Remember, all rent schedules and rent increases must be approved by the PJ.

The HOME regulations at 24 CFR 92.252 (b)(2) establish specific requirements for charging the correct rents in projects that receive project-based assistance.

3.4.B. Setting Rents in Units Financed with Low-Income Housing Tax Credit (LIHTC) Assistance

The PJ must provide owners/managers with specific guidance when a HOME-assisted unit also receives Federal LIHTC assistance, particularly on:

- Rent limits;
- Tenant-paid utilities; and
- Over-income tenants.

Rent Limits in HOME/LIHTC Properties

The HOME and LIHTC programs have different rent limit requirements. When a HOME-assisted unit is also designated as a LIHTC unit, “the lesser of” rule applies, as follows:

- Rents for Low HOME Rent units cannot exceed the *lesser of* the HUD-published Low HOME rent limit or the LIHTC rent limit for that unit; and
- Rents for High HOME Rent units cannot exceed the *lesser of* the HUD-published High HOME rent limit or the LIHTC rent limit for that unit.

This means that the owner/manager must determine the maximum allowable rent for each of the programs, and then use the lower rent.

Tenant-Paid Utilities in HOME/LIHTC Properties

When a tenant pays for utilities, both HOME and LIHTC require the owner/manager to deduct a utility allowance from the rent limit, in order to determine the maximum amount that an owner/manager may charge for rent. However, each program (HOME and LIHTC) may use a different utility allowance schedule. Therefore, when determining the maximum allowable HOME rents, owners/managers must subtract the tenant-paid utilities from the HOME rent limit using the PJ’s utility allowance. Then, owners/managers must use the LIHTC utility allowance to subtract tenant-paid utilities from the LIHTC rent limit. Once the owner determines the maximum allowable rent for each program, the lower rent applies. Utility allowances for each program are updated and issued annually. It is important to use current allowances.

Over-Income Tenants in HOME/LIHTC Properties

During recertification, owners/managers may find that some tenants have become over-income. This means that the income of the household increases to a level above the income limit for each program for that year. For HOME/LIHTC properties, the HOME Program has adopted the LIHTC guidelines for establishing rent for over-income households. Generally, a tenant household is considered “over-income” when its income increases to 140 percent or more of the qualifying income for that unit. (There is some variation state by state in terms of how this situation is handled.) Until the household’s income reaches this threshold, the tenant must pay no more than the lesser of the HOME rent limit or the tax credit rent. Once the tenant household’s income increases to over 140 percent of the qualifying income, the household is over-income. The steps the owner/manager must take to restore compliance to the property for HOME and LIHTC will vary, depending on whether the property has fixed or floating HOME units, whether or not 100 percent of the units are either HOME-assisted or LIHTC units, and what percentage of units are assisted and non-assisted units.

The guidance in Chapter 4, Sections 4.3 and 4.4 of this guide does not apply to any unit that is counted as both a HOME and LIHTC unit when a tenant’s income goes over-income. For more information on managing properties that have both HOME funds and low-income housing tax credits, see HUD’s updated HOME/LIHTC model program guide, expected publication 2009.

The availability of this publication will be announced on the HOME Program web page at www.hud.gov/homeprogram/.

Attachment 5-C, *Differences in LIHTC and HOME Rules for Property Management*, located at this end of this chapter, summarizes the key rental management differences between the HOME and LIHTC Programs.

Tips for PJs: Rents Limits in HOME/LIHTC Properties

To make it easier to determine rent limits in projects with HOME and LIHTC assistance, where tenants pay for utilities, it is advisable for the PJ to adopt the LIHTC utility allowance for the project.

3.4.C. Setting Rents in Group Homes

A group home is housing that is occupied by two or more single persons or families. It consists of common space and/or facilities for group use by the occupants of the units (except in the case of shared one bedroom units), and separate private space for each individual/family. Group homes often house the elderly or persons with disabilities. Typically, each individual/family pays a share of the total rent for a group home.

A HOME-assisted group home is treated as a single HOME-assisted housing unit with multiple bedrooms. The HOME rent limit for a group home is the HUD-published Fair Market Rent (FMR) limit for the total number of bedrooms in the group home. Although under the Section 8 program some localities use an exception to the Section 8 rents, these exception rents cannot be used as the rent for a HOME-assisted group home.

Rent Limits in Units with Live-In Staff

The bedrooms of live-in supportive service providers or other non-client staff are not included when calculating the total number of bedrooms for the purpose of establishing the rent. For example, if one bedroom in a four-bedroom group home is occupied by a service provider, the maximum rent for the group home is the HUD-published FMR Limit for a three-bedroom unit.

Tenant's Share of Rent in Group Homes

When the group home is shared by all tenants, owners/managers can pro-rate the total rent to determine each tenant's rent charge; the method of determining each tenant's share of rent should be fair and equitable.

The HUD-published FMR limit is the *maximum combined* rent that owners/managers can charge *all* income-eligible tenants that reside in a group home unit, regardless of the total number of tenants.

Rent Limits for Units with More than Six Bedrooms

Like the HOME rent limits, the HUD-published FMRs are adjusted for each bedroom size unit from zero bedrooms (efficiency) to six bedrooms. For units with seven or more bedrooms, owners/managers must calculate the rent limit. This is done by adding fifteen percent of the four-bedroom FMR for each additional bedroom. For example:

$$7 \text{ bedroom rent limit} = 1.45 \times 4 \text{ bedroom rent limit}$$

$$8 \text{ bedroom rent limit} = 1.60 \times 4 \text{ bedroom rent limit}$$

Attachment 5-D, *Calculating Fair Market Rents for Units with More than Six Bedrooms*, provides an illustration of how this calculation is done.

Utility Allowances in Group Homes

When group home tenants pay directly for utilities, the owner/manager must subtract the PJ's utility allowance from the HUD-published FMR limit in order to determine the maximum combined rent that can be charged to all the tenants. Section 3.2.E discusses utility allowances.

Rent and Additional Services in Group Homes

Group homes frequently include food and/or other supportive services to its residents. Group home rents may *not* include food costs or the costs of any supportive services. Costs for such services must be billed as separate charges. For group home units that are developed for persons with disabilities, disability-related services must be *non-mandatory*.

The lease must also state whether the fee-based services are optional or mandatory and must identify the amount of the additional fees or surcharges separately from the basic HOME Rent for each tenant.

Tips for PJs: HOME Rent Limits for Group Homes

Notifying Owners of Rent Limits

HUD establishes and publishes the FMR limits each year, along with the HOME rent limits, as illustrated in Exhibit 3-1. Like the HOME rent limits, the FMR limits are adjusted for different localities and for each bedroom-size unit from zero (efficiency) to six bedrooms. The PJ must provide the applicable FMRs to the owner/manager before the property begins to lease-up, and on an annual basis throughout the property's affordability period. The PJ can establish rent limits that are *lower* than the FMR limits that are established by HUD. If the PJ's group home rent limits exceed the most recent HUD-published rent limits, the PJ must instruct the owner/manager to use the lower HUD-published rent limits for that year.

The latest HUD-published FMR limits are posted on HUD's HOME Program web page at: <http://www.hud.gov/homeprogram/>.

Additional Services in Group Homes

Food and supportive service costs must be billed separately and may not be included in the rent. If there are any other mandatory fees the PJ must approve them in writing. Generally these costs are deducted from the HOME rent limit. Prior to approving any mandatory fees, PJs should consult with the HUD Field Office on a project-by-project basis.

3.4.D. Setting Rents in Single Room Occupancy (SRO) Housing

A single room occupancy (SRO) housing unit consists of a single room dwelling unit that is the primary residence of its occupant(s). It may or may not have food preparation and sanitary facilities.

The rent limit for an SRO unit is based *either* on the HUD Fair Market Rent (FMR) limit or the High and Low HOME rent limits, depending on the unit's characteristics, as described in Exhibit 3-4, below.

Exhibit 3-4: HOME Rents for SRO Housing

If the SRO housing has . . .	Then . . .
A unit with <i>neither</i> food preparation nor sanitary facilities, or with <i>one</i> (food preparation or sanitary facilities)	<p>The rent may not exceed 75 percent of the HUD-published FMR limit for a 0-bedroom (efficiency) unit. This limit is used for High HOME Rent units and Low HOME Rent units.</p> <p>Even though the rent limits are the same for High and Low HOME Rent units, in projects with five or more HOME-assisted units, at least 20 percent of the units must be occupied by very low-income tenants.</p>
A unit with <i>both</i> food preparation and sanitary facilities	<p>The High HOME Rent cannot exceed the HUD-published High HOME rent limit or Low HOME rent limit for a 0-bedroom (efficiency) unit.</p> <p>The Low HOME Rents for these units cannot exceed either:</p> <ol style="list-style-type: none"> 1. The HUD-published Low HOME rent limit for a 0-bedroom (efficiency) unit; or 2. 30 percent of the monthly adjusted family income of the very low-income tenant. (Section 3.2 discusses optional rent limits for Low HOME Rent units.) <p>In projects with five or more HOME-assisted units, at least 20 percent of the units must be occupied by very low-income tenants.</p>
A Low HOME Rent unit that receives state or Federal <i>project-based</i> rental assistance and is occupied by a very low-income tenant	The rent can be the applicable state or Federal project-based rent, as long as it is occupied by a very low-income tenant who does not pay more than 30 percent of the family's monthly adjusted income for rent. Section 3.4.A discusses how to determine rents for HOME-assisted units receiving state or Federal project-based rental assistance.

Low HOME Rent Units in SRO Housing

Unlike in group homes, in SRO housing with five or more HOME-assisted rental units, at least 20 percent of the units must be set aside as Low HOME Rent units for occupancy by very low-income tenants.

Utility Allowances in SRO Housing

Utility costs are included in the maximum HOME SRO rents. If SRO tenants pay directly for utilities, the owner/manager must subtract the PJ's utility allowance from the HUD-published HOME rent limit or FMR limit in order to determine the maximum rent that can be charged for the SRO unit. Section 3.2.E discusses utility allowances.

Rent and Additional Services in SRO Housing

SRO unit rents may not include food costs or the costs of any supportive services. Costs for such services must be billed as separate charges. For SRO units that are developed for persons with disabilities, disability-related services must be *non-mandatory*.

Each SRO tenant's lease must clearly state whether the fee-based services are optional or required and must also identify the amount of the additional fees or surcharges separately from the basic HOME rent for each tenant. The PJ must approve the cost of any mandatory services; generally, these costs are deducted from the HOME rent limit. Prior to approving any mandatory fees, PJs should consult with the HUD Field Office on a project-by-project basis.

Tips for PJs: HOME Rent Limits in SRO Housing

The PJ must provide owners/managers with the applicable FMR and HOME rent limits and utility allowances before an SRO rental property starts to lease-up, and provide updated FMR and HOME rent limits on an annual basis until the end of the property's affordability period. The HOME rent limits and FMR limits are updated annually and are made available on the HOME Program web page at www.hud.gov/homeprogram/.

The PJ has the option to issue rent limits that are more restrictive than those imposed by HUD. If, during the affordability period, the PJ's rent limits exceed the most recent HUD-published HOME rent limits, the PJ should instruct the owner/manager to charge rents that do not exceed the lower HUD-published HOME rent limits.

Additional Services in SRO Housing

Food and supportive service costs must be billed separately and may not be included in the rent. If there are any mandatory fees the PJ must approve the cost in writing. Generally these costs are deducted from the HOME rent limit. Prior to approving any mandatory fees, PJs should consult with the HUD Field Office on a project-by-project basis.

Attachment 3-A: Illustration of How to Calculate HOME Rent Limits for Units with More than Six Bedrooms

Scenario: The property manager needs to determine the HOME rent limit for two seven-bedroom units. One unit is a High HOME Rent unit and one unit is a Low HOME Rent unit.

Step 1. Identify the starting points.

- The percentage increase allowed by HUD for each additional bedroom is 15 percent.
- The High HOME rent limit for a 4-bedroom unit in the area is \$691.
- The Low HOME rent limit for a 4-bedroom unit in the area is \$645.

Step 2. Determine by how many bedrooms the unit exceeds four bedrooms.

$$7 \text{ bedrooms} - 4 \text{ bedrooms} = 3 \text{ bedrooms}$$

Step 3. Multiply 15 percent by the number of additional bedrooms over four bedrooms.

$$15\% \times 3 = 45\%$$

Step 4. Add this percentage to 100 percent and convert to a decimal.

$$45\% + 100\% = 145\%, \text{ or } 1.45$$

Step 5. Multiply the decimal percentage (from Step 4) times the HUD-published 4-bedroom High HOME rent limit and Low HOME rent limit.

$$1.45 \times \$691 = \$1001.95 \text{ (High HOME Rent)}$$

$$1.45 \times \$645 = \$935.25 \text{ (Low HOME Rent)}$$

Attachment 3-B: Determining Rents for Units with Tenant-Paid Utilities

To determine the maximum rent that an owner/manager can charge for a HOME-assisted unit, all tenant-paid utilities must be deducted from the applicable HUD-published HOME rent limit.

In this illustration, a tenant of a 2-bedroom High HOME Rent unit in Anywhere USA pays some of its own utilities. The unit has electric heat and cooking, and a gas hot water heater. The tenant is responsible for paying for gas, electricity, and water.

Step 1: Look up the High HOME Rent limit for a 2-bedroom unit:

Anywhere MSA	Eff.	1 BR	2 BR	3 BR	4 BR	5 BR	6 BR
Low HOME Rent Limit	\$827	\$866	\$1,063	\$1,228	\$1,370	\$1,511	\$1,653
High HOME Rent Limit	\$995	\$1,086	\$1,286	\$1,500	\$1,654	\$1,806	\$1,959
<i>For Information Only:</i>							
Fair Market Rent (FMR)	\$995	\$1,134	\$1,286	\$1,659	\$2,171	\$2,497	\$2822
50% Rent Limit	\$827	\$866	\$1,063	\$1,228	\$1,370	\$1,511	\$1653
65% Rent Limit	\$1,013	\$1,086	\$1,306	\$1,500	\$1,654	\$1,806	\$1,959

The High HOME Rent limit for a 2-bedroom unit is \$1,286.

Step 2: Look up the utility allowance for the utilities that are paid by the tenant:

Utility	0 BR	1 BR	2 BR	3 BR	4 BR	5BR
Heating – Gas	21.31	29.83	38.36	46.88	59.67	68.19
Heating- Elec	25.10	35.14	45.18	55.22	70.28	80.32
Heating- Propane	26.64	37.30	47.96	58.62	74.61	85.26
Heating- Fuel Oil	39.02	54.63	70.24	85.85	109.26	124.87
Cooking- Gas	3.55	4.97	6.39	7.81	9.94	11.37
Cooking- Electric	4.06	5.68	7.31	8.03	11.37	12.99
Cooking- Propane	4.33	6.06	7.79	9.53	12.12	13.86
Hot Water- Gas	9.32	13.05	16.78	20.51	26.11	29.83
Hot Water- Elec	12.55	17.57	22.59	27.61	35.14	40.16
Hot Water- Propane	11.32	15.85	20.38	24.91	31.71	36.24
Hot Water- Fuel Oil	16.58	23.22	29.85	36.48	46.43	53.07
Electricity	12.00	16.79	21.59	26.39	33.59	38.39
Water	3.56	3.56	7.19	11.80	13.56	16.95
Sewer	4.53	4.53	9.15	15.01	17.26	21.57
Air Conditioning	6.64	9.30	11.96	14.62	18.60	21.26

Attachment 3-B:
Determining Rents for Units with Tenant-Paid Utilities*(continued)*

The tenant-paid utilities include:

Electric heat	\$45.18
Cooking—Electric	7.31
Electricity	21.59
Hot water—Gas	16.78
Water	7.19
<hr/>	
Total Tenant-Paid Utilities	\$98.05

Step 3: Deduct the tenant-paid utilities from the High HOME Rent limit.

$$\$1286 - \$98.05 = \$1187.95$$

The maximum amount of rent that the owner can charge for this unit is \$1187.95.

Note: If this unit were to be redesignated as a Low HOME Rent unit in the future, the tenant-paid utilities would be deducted from the Low HOME Rent limit (\$1,063) to determine the maximum amount that could be charged for the unit as a Low HOME Rent unit ($\$1,063 - \$98.05 = \$964.95$).

Attachment 3-C:

Differences in LIHTC and HOME Rules for Property Management

In general, when a property has both HOME and Low-Income Housing Tax Credit (LIHTC) assistance, both sets of program rules apply, so the stricter requirements of each program must be met. Key property management issues that vary between the programs include:

- **Income Targeting and Occupancy Requirements.** The owner or manager must rely on its use agreements and the rules for each program to determine the number of HOME and tax credit units in the property, and the required household income at move-in for each unit. When a household's income meets both sets of requirements and the rent is below the maximum for both programs, the unit that household occupies can be counted toward the requirements of both programs. Otherwise, if a household meets only one set of requirements, the unit can be counted for that program only.
- **Maximum Allowable Rent Determinations.** The owner/manager must determine the maximum allowable rents for both programs and use the lower rents as the rent limit for the unit. Maximum rent limits include utilities for both programs, so if the tenant pays for utilities, the owner/manager must deduct the appropriate utility allowance to determine the rent limit.
 - **Utility Allowances.** LIHTC and HOME may use different utility allowances. The owner/manager must deduct the LIHTC utility allowance from the LIHTC rent limit to determine the maximum allowable LIHTC rent. The owner/manager must deduct the PJ's utility allowance from the HOME rent limits to determine the maximum allowable High HOME Rent and Low HOME Rent. The maximum rent the owner/manager can charge is the lesser amount.
- **Affordability and Market Rents.** HOME and LIHTC each have established rent limits. In some cases, the rent limits imposed by the LIHTC and HOME programs will result in a higher rent for a unit than the market will actually bear. For example, a two-bedroom unit might have a maximum tax credit rent of \$660, a maximum HOME rent of \$625, and a maximum achievable market rent of \$500. Regardless of the program rent limits, in this situation the property cannot charge more than the market will pay. This lower market rent complies with the LIHTC and HOME rent restrictions. It is perilous to assume that the property will achieve its 'use-restricted' rent limits, particularly in an area where rents are low in relation to area median incomes. Owners and managers should establish rents that reflect the market for the community.
- **Reductions in Rents.** If HOME rent limits or Fair Market Rents decline, rents at HOME/LIHTC properties may have to be lowered. The HOME Program does not require that owners reduce rents for HOME-assisted units below the level in effect at the time of project commitment. However, LIHTC rules do not provide similar protections. Therefore, if a unit is counted toward both sets of requirements, and the rent limit decreases, a rent decrease may be necessary to ensure continued compliance with LIHTC rules.
- **Initial Tenant Income-Eligibility.** Both LIHTC and HOME require owners/managers to determine a tenant household's income-eligibility prior to leasing a unit, and both programs require owners/managers to use source documentation to do so.
 - **Definition of Income.** LIHTC requires the use of the Section 8 (Part 5) Program definition of income; the HOME Program permits the PJ to choose the definition of income from three options, including the Part 5 definition. Owners/Managers should request that the PJ permit them to use the Part 5 definition for consistency.
 - **Asset Income.** Although LIHTC permits tenants to certify asset amounts and asset income that are less than \$5,000, the HOME Program requires *all* asset income to be verified with source documentation. Therefore, all asset income must be verified for any unit that will count as both a tax credit and a HOME unit.
- **Recertifying Tenant Income.** Both the HOME and LIHTC programs require assisted units to remain occupied by income-eligible persons throughout the affordability (compliance) period. For both programs,

property owners/managers must certify tenants' incomes annually to ensure they continue to be income-eligible in accordance with applicable income limits. Both programs use income limits that are updated and issued by HUD annually, although each program may impose different income targeting requirements. For a unit to continue to count as both a HOME and LIHTC unit, the tenant's income must continue to qualify under each program.

- **Source Documentation.** The HOME Program permits some flexibility in methods of recertifying annual income. For projects with both LIHTC-assisted and non-assisted units, the LIHTC program requires a review of source documentation every year to verify income-eligibility; for projects with 100 percent LIHTC units, income recertification is not required. Therefore, property owners/managers of HOME/LIHTC properties with both LIHTC-assisted and non-assisted units must verify tenant income using source documentation annually (i.e., cannot use the recertification methodology permitted by the HOME regulations). For projects with 100 percent LIHTC units, the PJ can adopt one of HOME's alternative recertification methods.
- **Over-Income Tenants.** During recertification, owners/managers may find that some tenants have become over-income. This means that the income of the household increases to a level above the income limit for each program for that year. For HOME/LIHTC properties, the HOME Program has adopted the LIHTC guidelines for establishing rent for over-income households. Generally, a tenant household is considered "over-income" when its income increases to 140 percent or more of the qualifying income for that unit. (There is some variation state by state in terms of how this situation is handled.) Until the household's income reaches this threshold, the tenant must pay no more than the lesser of the HOME rent limit or the tax credit rent. Once the tenant household's income increases to over 140 percent of the qualifying income, the household is over-income. The steps the owner/manager must take to restore compliance to the property for HOME and LIHTC will vary, depending on whether the property has fixed or floating HOME units, whether or not 100 percent of the units are either HOME-assisted or LIHTC units, and what percentage of units are assisted and non-assisted units. Note, the guidance in Chapter 4, Sections 4.3 and 4.4 of this guide does not apply to any unit that is counted as both a HOME and LIHTC unit when a tenant's income goes over-income. Guidance on what steps must be taken is provided in HUD's updated HOME/LIHTC model program guide, expected publication 2009. The availability of this publication will be announced on the HOME Program web page at www.hud.gov/homeprogram/.
- **Affordability (Compliance) Period.** HOME affordability periods are specified in the written agreement between the owner and the PJ. LIHTC compliance periods are specified in the property's allocation agreement with the state, and are specific to each property. The property must comply with HOME rules for the duration of the HOME affordability period, and must comply with LIHTC rules for the duration of the LIHTC compliance period.
- **Property Inspections.** Both programs require the funding agency to inspect the property on a periodic basis. HOME/LIHTC units must comply with HOME's applicable property standards throughout the affordability period. PJs will notify owners of the property inspection schedule.
- **Section 8.** Both the LIHTC and HOME Programs permit the maximum rent to exceed program requirements on units with *project-based* Section 8 rental assistance. (In HOME, this exception applies only for Low HOME Rent units.) Note that the HOME rent limits apply to units occupied by tenants with tenant-based rental assistance.

Attachment 3-D:

Calculating Fair Market Rents for Units with More than Six Bedrooms

Scenario: The property manager needs to determine the FMR for a seven-bedroom group home unit.

Step 1. Identify the starting points.

- The percentage increase allowed by HUD for each additional bedroom is 15 percent.
- The FMR for a 4-bedroom unit in the area is \$691.

Step 2. Determine by how many bedrooms the unit exceeds four bedrooms.

$$7 \text{ bedrooms} - 4 \text{ bedrooms} = 3 \text{ bedrooms}$$

Step 3. Multiply 15 percent by the number of additional bedrooms over four bedrooms.

$$15\% \times 3 = 45\%$$

Step 4. Add this percentage to 100 percent and convert to a decimal.

$$45\% + 100\% = 145\%, \text{ or } 1.45$$

Step 5. Multiply the decimal percentage (from Step 4) times the HUD-published 4-bedroom FMR.

$$1.45 \times \$691 = \$1,001.95$$

Chapter 4: Maintaining Unit Mix during the Affordability Period

4.1. Overview

PJs must provide detailed instruction to owners/managers on how to ensure that income-eligible tenants occupy HOME-assisted units and are charged the appropriate rents throughout the affordability period. This section explains the HOME occupancy and unit mix requirements and provides guidance on how to maintain the required number of High HOME Rent units and Low HOME Rent units, and what to do when a tenant's income goes over the HOME income limits during the affordability period. The chapter further explains how the requirements vary for properties with fixed HOME-assisted units and for properties with floating HOME-assisted units.

4.1.A. Maintaining Unit Mix: Summary of HOME Requirements

The PJ determines if a property has fixed or floating HOME-assisted units at the time of project commitment. The PJ must provide different guidance for owners of properties with fixed HOME-assisted units and for owners of properties with floating HOME-assisted units.

Properties with **fixed HOME units** have specific units (e.g., Units 101, 102, and 103) that are designated as HOME-assisted. Owners/Managers must maintain these specific units (units 101, 102, and 103) as HOME-assisted units throughout the affordability period. In addition, PJs must also tell owners how many units must be designated as High HOME Rent and Low HOME Rent units. Owners/Managers must maintain the *original number* of High HOME rent units and Low HOME rent units throughout the affordability period. However, unit designations as High HOME Rent units and Low HOME Rent units may change during this time.

Properties with **floating HOME units** do not have specific units that are designated HOME-assisted for the duration of the affordability period. The PJ designates specific units as HOME-assisted initially, but the owner does not need to maintain those specific units as HOME-assisted. Instead, throughout the affordability period, the owner maintains the *total number* of HOME-assisted and non-assisted units that are originally designated. The HOME-assisted unit designations change, or “float” among comparable assisted and non-assisted units during this time in order to keep the original mix of assisted and non-assisted units. For example, if a property has an over-income tenant in a HOME-assisted unit, when the next comparable *non-assisted* unit becomes available, it is redesignated as HOME-assisted and rented to an income-eligible tenant. The unit occupied by the over-income tenant is redesignated as a non-assisted unit. In addition, the number of High and Low HOME Rent units that are designated at the time of project commitment must also stay the same.

When redesignating units, in order to maintain the required unit mix, owners/managers must substitute a comparable unit. They can choose to substitute a “greater” unit for a “lesser” unit. A “greater” unit is one that might be considered more preferable because of larger size, additional bedrooms, or amenities. This type of substitution is not required. However, owners/managers are never permitted to substitute a “lesser” unit for a greater one.

Maintaining the required number of HOME-assisted units, High HOME Rent units, and Low HOME Rent units is called complying with the **unit mix requirements**.

When an owner/manager recertifies a tenant's income, he or she may find that the tenant's income has increased. A tenant is considered **over-income** in the HOME Program when:

- The tenant occupies a High or Low HOME Rent unit and the household income increases over the current HOME low-income limit for its family size, or
- The tenant occupies a Low HOME Rent unit and the household's income increases above the current very low-income limit, but is still below the low-income limit for its family size.

When a tenant is over-income, the unit that the tenant occupies is considered **temporarily out of compliance** with HOME's occupancy and unit mix requirements. Temporary noncompliance due to an increase in an existing tenant's income is permissible as long as the owner takes specific steps to restore the correct occupancy and unit mix in the property as soon as possible. The rents of tenants whose incomes exceed the low-income limit must also be adjusted as soon as the tenant's lease permits. However, owners/managers may not evict or terminate the tenancy of a household because its income increased.

Tips for PJs: Decisions that Affect the Property's Unit Mix

The PJ must determine, inform the owner, and document in the written agreement:

- Whether the property has fixed or floating HOME-assisted units;
- How many units are HOME-assisted; and
- Location of HOME-assisted units (i.e., which specific units are HOME-assisted).

Fixed vs. Floating HOME-Assisted Units

The PJ determines whether a property has fixed or floating HOME-assisted units at the time of project commitment. It can establish one policy for all its assisted projects, or it can make this determination on a project-by-project basis.

When determining whether a property should have fixed or floating HOME-assisted units, the PJ should consider:

- **Comparability of units.** Only properties that have units that are comparable in terms of size, amenities, and number of bedrooms can be designated as floating HOME units.
- **Experience of management.** Relatively new property managers and rental property managers who are inexperienced with managing HOME-assisted properties may find it easier to manage properties with fixed HOME units since the unit designations of fixed properties do not change during the period of affordability.
- **Integration of affordable units.** When the HOME units "float" in the property, tenants are less likely to be stigmatized by their occupancy in the assisted units, because the HOME-assisted units are not readily identifiable.
- **Ease of monitoring.** Since the rules vary for managing fixed and floating units, the PJ may find it easier to monitor if it adopts either fixed or floating units for all its properties.

Determining the Minimum Number of HOME-Assisted Units

The PJ must designate the number of HOME-assisted units at the time of project commitment. The minimum number of units is based on the amount of the HOME investment. The process for determining this number varies depending on whether the units are comparable or not. Comparable units have the same number of bedrooms, amenities, and square footage.

- When units are *not* comparable, the minimum number of HOME-assisted units is based on:
 - The *actual* units in which HOME funds are invested (i.e., the actual costs for the HOME-assisted units, plus a proportional share of the HOME-eligible common costs). These costs cannot exceed the maximum per unit subsidy limit.
 - For example, if the PJ rehabilitates six units that are not comparable, the PJ must track the development costs by unit. If the PJ invests \$25,000 per unit for three 3-bedroom units, and invests only private funds in the remaining units, then those three units are HOME-assisted.
- When units *are* comparable, the minimum number of HOME-assisted units is based on either:
 - The proportional share of total HOME-eligible costs paid with HOME funds, in relation to the total eligible development cost; or
 - The maximum per unit subsidy limit, in relation to the total eligible development cost.

The HOME maximum per unit subsidy is based on the 221(d)(3) limits. These limits are available on the HOME Program web page at www.hud.gov/homeprogram/.

Exhibit 4-1 illustrates how to determine the minimum number of HOME-assisted units in a project with comparable units.

The PJ may designate more than the minimum number of HOME-assisted units, if it so chooses.

Designating Accessible Units as HOME-Assisted

In rental properties that are comprised of both assisted and non-assisted units, the PJ determines if the accessible units are to be designated as HOME-assisted or not. This is true regardless of whether the property has fixed or floating HOME units. HUD encourages the PJ to consider the needs of the disabled population when making this determination.

Exhibit 4-1: Process for Determining the Minimum Number of HOME-Assisted Units When the Units Are Comparable

Scenario: The Paradise PJ plans to develop a 10-unit rental property. It will invest \$450,000 in HOME funds. The maximum per unit subsidy for the planned bedroom size in this locality is \$80,000. The units will all be the same square footage, have two bedrooms, and have the same amenities.

Paradise PJ must perform two tests, to determine the *minimum* number of units that it must designate HOME-assisted.

Test 1: Fair Share Test

Step 1: Determine the total eligible project costs	\$900,000
Step 2: Determine the planned HOME investment	\$450,000
Step 3: Divide the HOME investment by the total project cost and convert to a percentage	$\frac{\$450,000}{\$900,000}$ $= .5$ $= 50\%$
Step 4: Multiply the number of total units in the development by the cost percent (determined in Step 3), to get the pro-rata share.	10 total units $\times 50\%$ $= \mathbf{5 \text{ units}}$
Step 5: If the result is not a whole number, round up.	

Test 2: Per Unit Subsidy Test

Step 1: Determine the total eligible project costs	\$900,000
Step 2: Identify the maximum per unit subsidy	\$ 80,000
Step 3: Divide the total eligible project costs by the maximum per unit subsidy	$\frac{\$450,000}{\$80,000}$ $= 5.6 \text{ units}$
Step 4: Note—if the result is not a whole number, round up:	6 units

Minimum Number of HOME Units is the greater number, of the Fair Share Test and the Per Unit Subsidy Test

Paradise PJ must designate at least six of the units as HOME-assisted.

For more information on determining the number of HOME-assisted units in a property, refer to HUD Notice CPD-98-02, *Allocating Costs and Identifying HOME-Assisted Units in Multifamily Projects*, issued March 18, 1998. This Notice is available online at: <http://www.hud.gov/offices/cpd/affordablehousing/lawsandregs/notices/#1998>.

Location of HOME-Assisted Units

PJs should minimize the stigma to tenants occupying HOME-assisted units. The assisted units should not be isolated, but should be generally distributed throughout the property. If the property has more than one building, the HOME-assisted units should be equally distributed throughout the buildings unless there is a compelling reason to do so. In properties with floating HOME units, it is expected that the random nature of unit turnover during the affordability period should help ensure that this distribution is maintained.

4.2. Vacated HOME-Assisted Units

Generally, when either a fixed or a floating HOME-assisted unit is vacated and the property is in compliance with the unit mix requirements (that is, there are no over-income tenants in any of the HOME-assisted units), the owner must take the following steps to fill the vacancy:

- Rent a High HOME Rent unit that is vacated to a new low-income tenant, at a rent that does not exceed the High HOME rent limit.
- Rent a Low HOME Rent unit that is vacated to a new very low-income tenant, at a rent that does not exceed the Low HOME rent limit.

However, if there is an over-income tenant occupying a HOME-assisted unit in the property, the steps that the owner/manager must take will depend on whether the property has fixed or floating HOME-assisted units:

- For steps with fixed HOME units, see Section 4.3, Over-Income Tenants in a Property with Fixed HOME Units.
- For steps with floating HOME units, see Section 4.4, Over-Income Tenants in a Property with Floating HOME Units.

4.3. Over-Income Tenants in a Property with Fixed HOME Units

When an owner/manager recertifies a tenant's income and finds that it has increased above the HOME income limits, the steps that the owner/manager takes to restore compliance depend on whether the over-income tenant occupies a High HOME Rent unit or a Low HOME Rent unit. If the tenant occupies a Low HOME Rent unit, the steps also depend on whether or not the tenant is low-income. The possible steps are outlined in Sections A, B, and C, below, and are illustrated in Exhibit 4-2. An example of how these steps apply is provided in Exhibit 4-3.

4.3.A. Steps When an Over-Income Household Occupies a Fixed High HOME Rent Unit

The property is temporarily out of compliance until the unit with an over-income tenant is vacated and can be rented to another low-income tenant household.

The owner/manager *must* raise the over-income household's rent as soon as possible, in accordance with the terms of the lease. The rent for the over-income tenant must be adjusted such that the tenant pays the lesser of:

- The rent amount payable under state or local law;
- 30 percent of the tenant's monthly adjusted family income (see Attachment 6-4, *Calculating Adjusted Household Income for the Purpose of Establishing Rent*, at the end of this chapter; or

If the unit is a LIHTC unit, the tenant must pay the rent dictated by the tax credit program.

This new rent is set irrespective of market rents in the neighborhood.

The owner/manager cannot terminate or refuse to renew the lease based on the household's increased income.

4.3.B. Steps When a Tenant Is Low-Income, but Is Not Very Low-Income, and the Household Occupies a Fixed Low HOME Rent Unit

The property is temporarily out of compliance until either: (1) a High HOME Rent unit can be redesignated as a Low HOME Rent unit, or (2) the unit occupied by the over-income tenant is vacated and can be rented to another very low-income tenant household.

The unit that is occupied by the over-income tenant retains its designation as a Low HOME Rent unit until another unit can be redesignated as the Low HOME Rent unit. For as long as the unit retains the Low HOME Rent designation and is occupied by a low-income household, the owner/manager may not increase the tenant's rent above the Low HOME rent limit.

When a High HOME Rent unit in the property vacates, regardless of bedroom size, the unit must be redesignated as a Low HOME Rent unit and rented to a very low-income tenant, at no more than the Low HOME Rent. Once a new Low HOME Rent unit has been designated, the unit that is occupied by the over-income tenant must be redesignated as a High HOME Rent unit. At this time, the owner/manager can increase the tenant's rent up to the High HOME Rent, subject to terms of the lease.

4.3.C. Steps When a Tenant Household's Income Is Above the Low-Income Limit and It Occupies a Fixed Low HOME Rent Unit

The property is temporarily out of compliance and will continue to be out of compliance until the over-income tenant moves out and another income-eligible tenant household moves in.

The owner/manager *must* adjust the over-income household's rent as soon as the lease permits. The over-income tenant must pay the lesser of:

- The rent amount payable under state or local law;
- 30 percent of the tenant's monthly adjusted family income (see Attachment 6-4, *Calculating Adjusted Household Income for the Purpose of Establishing Rent*, at the end of this chapter; or

If the unit is also a LIHTC unit, the tenant must pay the rent dictated by the tax credit program.

This new rent is set irrespective of market rents in the neighborhood.

The owner/manager cannot terminate or refuse to renew the lease based on the household's income.

When a High HOME Rent unit becomes available, regardless of bedroom size, it must be redesignated as a Low HOME Rent unit. This unit must be rented to a very low-income tenant, at no more than the Low HOME Rent. Then, the unit that is occupied by the over-income tenant must be redesignated as a High HOME Rent unit. Even though the unit is redesignated a High HOME Rent unit, since the tenant is over the low-income limit, the property continues to be temporarily out of compliance.

Exhibit 4-2: Maintaining Unit Mix in Fixed HOME Units When a Tenant Goes Over Income

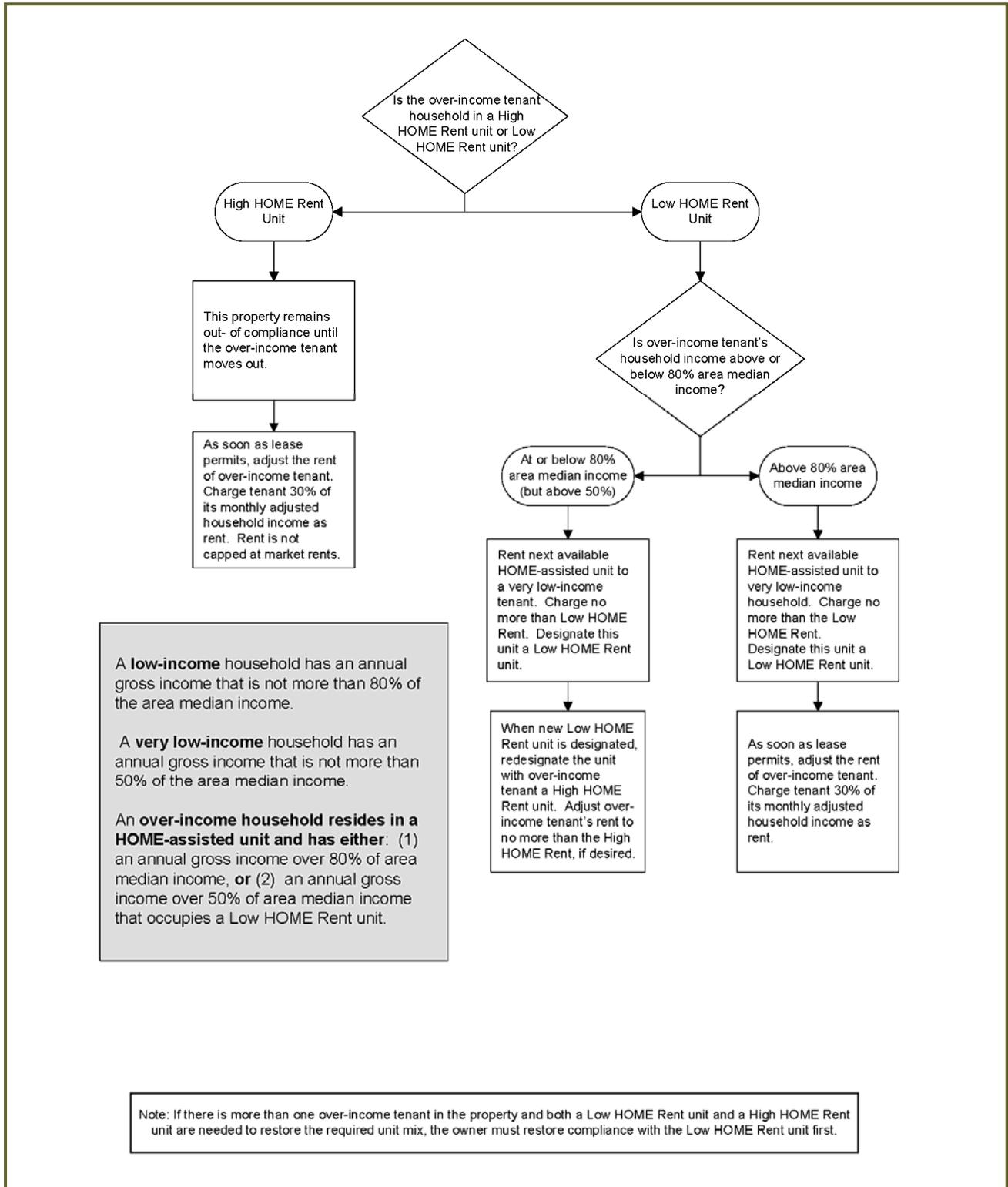


Exhibit 4-3: Example of Maintaining Unit Mix in a Property with Fixed HOME Units

Consider a property that has 20 comparable 1- and 2-bedroom apartments with fixed HOME units. The property has ten 1-bedroom and ten 2-bedroom apartments, with five units of each unit size designated as HOME-assisted. Two units (one of each bedroom size) are designated as Low HOME Rent units. Throughout the affordability period, the owner must strive to have income-eligible tenants in each of the HOME-assisted units, as originally designated:

1BR	1BR	2BR	2BR
101 HOME-assisted High	201 Non-assisted	301 HOME-assisted High	401 Non-assisted
102 HOME-assisted High	202 Non-assisted	302 HOME-assisted High	402 Non-assisted
103 HOME-assisted High	203 Non-assisted	303 HOME-assisted High	403 Non-assisted
104 HOME-assisted High	204 Non-assisted	304 HOME-assisted High	404 Non-assisted
105 HOME-assisted: Low	205 Non-assisted	305 HOME-assisted: Low	405 Non-assisted

Scenario 1: Unit 303, a 2-bedroom High HOME Rent unit, becomes vacant. All the other HOME-assisted units are occupied by income-eligible tenants.

- Unit 303 retains its designation as a High HOME Rent unit. It must be rented to another low-income tenant, at no more than the High HOME Rent.

Scenario 2: The tenant in Unit 105, a one-bedroom Low HOME Rent unit, goes over-income when the owner/manager recertifies his/her income. The tenant no longer qualifies as very low-income, but qualifies as low-income. The property is temporarily out of compliance. A month later, unit 201 is vacated.

- Since Unit 201 is non-assisted, the owner/manager can rent it without regard to HOME restrictions, even though the tenant of Unit 105 is over-income. The property continues to be temporarily out of compliance.

Two months later, unit 103 is vacated.

- The owner/manager must redesignate Unit 103 as a Low HOME Rent unit, and must rent it to a very low-income tenant at no more than the Low HOME Rent.
- Once Unit 103 is redesignated as a Low HOME Rent unit, the owner must redesignate Unit 105 as a High HOME Rent unit and increase the tenant's rent to no more than the High HOME Rent.

Scenario 3: When the owner/manager recertifies the income of the household in Unit 105, he finds that the tenant is over-income. The tenant still qualifies as low-income. Two weeks later, Unit 301 is vacated.

- Since Unit 301 is a HOME-assisted 2-bedroom unit, it is "greater" than Unit 105. Nonetheless, because this property has fixed units, the owner must redesignate Unit 301 as a Low HOME Rent unit in order to restore compliance to the property.
- Unit 105 is redesignated as a High HOME Rent unit. Once this is done, the tenant's rent can be adjusted to up to the High HOME Rent.

Scenario 4: The owner recertifies the tenant incomes and finds that the tenant in Unit 105, a 1-bedroom High HOME Rent unit, has gone over-income.

- The property is temporarily out of compliance. Compliance can only be restored when this unit is vacated and rented to another low-income tenant.

When There Is More than One Over-Income Tenant in the Property

If there is more than one over-income tenant in the property and both a Low HOME Rent unit and High HOME Rent unit are needed to restore unit mix compliance, then the owner/manager should restore compliance with the Low HOME Rent unit first. This is true regardless of if the property has fixed or floating HOME units.

Redesignating Occupied Units to Restore Compliance

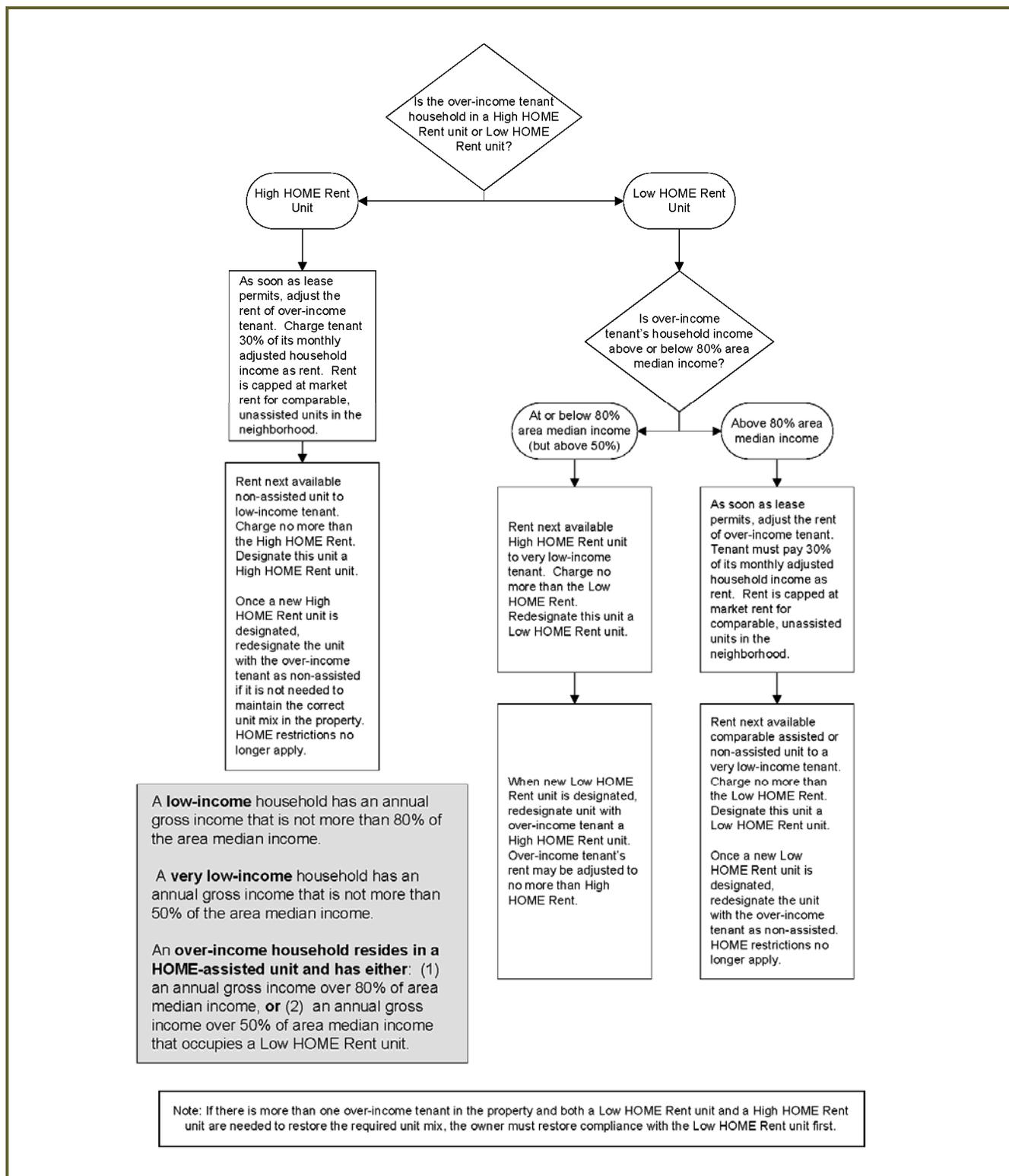
The owner/manager can redesignate occupied units to restore unit mix compliance. This might occur if a property has a Low HOME Rent unit occupied by an over-income tenant who is low-income, and a High HOME Rent unit that is occupied by a very low-income tenant. The owner/manager can “swap,” or redesignate the two units as a way of restoring compliance with the unit mix requirements. Once the unit designations are changed, the owner/manager can adjust the rents accordingly. This is true regardless of if the property has fixed or floating units.

4.4. Over-Income Tenants in a Property with Floating Units

When the owner/manager conducts the annual income recertification and finds that a tenant household’s income has increased above the HOME income limits, the steps that it takes to restore compliance depend on whether the over-income tenant occupies a High HOME Rent unit or a Low HOME Rent unit. If the tenant occupies a Low HOME Rent unit, the steps also depend on whether or not the tenant is low-income. The possible steps are outlined in Sections A, B, and C below and are illustrated in Exhibit 4-4.

An example of how these steps apply is provided in Exhibit 4-5.

Exhibit 4-4: Maintaining Unit Mix in Floating HOME Units When a Tenant Goes Over Income



4.4.A. Steps When an Over-Income Household Occupies a Floating High HOME Rent Unit

- The owner/manager must adjust the rent of the over-income tenant household so that it pays 30 percent of its monthly adjusted income as rent. (See Attachment 6-4, *Calculating Adjusted Household Income for the Purpose of Establishing Rent*, at the end of this chapter.) The rent adjustment must be made as soon as the lease permits, and in accordance with the terms of the lease. Note, unlike the rule for properties with fixed HOME-assisted units, in a property with floating HOME units a tenant is *not* required to pay more than the market rent for a comparable, unassisted unit in the neighborhood.
- The next vacant, comparable, non-assisted unit must be designated as a High HOME Rent unit. A comparable unit is one that is equal or greater in terms of size, number of bedrooms, and amenities. The owner may *not* replace the unit with one that is lesser, unless doing so preserves the original unit mix. The newly designated High HOME Rent unit must be rented to a tenant whose income does not exceed the low-income limit, at a rent that does not exceed the High HOME Rent.
- Once a comparable non-assisted unit is designated the new High HOME Rent unit, the unit with the over-income tenant is redesignated as a non-assisted unit. At this point, the owner/manager may adjust the tenant's rent without regard to the HOME rent requirements (although requirements from other funding sources may still apply). Rent increases are subject to the terms of the tenant's lease.

4.4.B. Steps When a Tenant Is Low-Income, But Is Not Very Low-Income, and Occupies a Floating Low HOME Rent Unit

- The unit that is occupied by the over-income tenant keeps its designation as a Low HOME Rent unit until a comparable unit can be substituted. The rent of the over-income tenant must not exceed the Low HOME rent limit while the unit is a Low HOME Rent unit.
- When the next High HOME Rent unit in the property is vacated, it must be redesignated as a Low HOME Rent unit rented to a tenant whose income does not exceed the very low-income limit, at a rent that does not exceed the Low HOME rent limit.
- Once the new Low HOME Rent unit is designated, the unit with the over-income tenant is redesignated as a High HOME Rent unit. The tenant's rent may be adjusted to no more than the High HOME rent limit.

4.4.C. Steps When a Tenant Household's Income Is Above the Low-Income Limit and It Occupies a Floating Low HOME Rent Unit

- The next vacant, comparable, non-assisted unit must be designated as a Low HOME Rent unit, and rented to a tenant whose income does not exceed the very low-income limit, at a rent that does not exceed the Low HOME rent limit.
- Until a comparable Low HOME Rent unit is designated, the unit that is occupied by the over-income tenant is considered a Low HOME Rent unit that is temporarily out of compliance.
- The rent of the over-income tenant in the original Low HOME Rent unit must be adjusted as soon as the lease permits, and in accordance with the terms of the lease.
- Until a comparable Low HOME Rent unit is substituted, the over-income tenant must pay 30 percent of the household's monthly adjusted income as rent. (See Attachment 6-4, *Calculating Adjusted Household Income for the Purpose of Establishing Rent*, at the end of this chapter.)
- After a comparable Low HOME Rent unit is substituted, the unit with the over-income tenant is redesignated a *non-assisted* unit. The owner/manager may adjust the tenant's rent without regard to the HOME restrictions. Rent increases are subject to the tenant's lease.

Exhibit 4-5: Maintaining Unit Mix in a Property with Floating HOME Units

Scenario 1:

The owner recertifies tenant incomes and finds that the tenant in Unit 106 (1 2-bedroom Low HOME Rent unit) is over-income. The tenant's household income now exceeds the low-income limit.

- As soon as the lease permits, the owner must adjust the tenant's rent to 30% of the household income, but no more than the market rate for a comparable unit in the neighborhood.

The following month, Unit 205 is vacated, a 1-bedroom non-assisted unit. As a 1-bedroom unit, it is "lesser" than Unit 106, a 2-bedroom unit.

- Because it is lesser, the owner cannot redesignate it as a Low HOME Rent unit. Unit 205 retains its non-assisted designation and can be rented to another tenant without HOME restrictions.

Two months later, Unit 110, a 2-bedroom, High HOME Rent unit, is vacated.

- The owner must redesignate Unit 110 as a Low HOME Rent unit and rent it to a very low-income tenant at no more than the Low HOME Rent.
- The owner then redesignates Unit 106 as a High HOME Rent unit.
- Note, the property continues to be out of compliance because the household's income exceeds the low-income limit.

Three months later, unit 210, a 2-bedroom, non-assisted unit, is vacated.

- The owner designates it as a High HOME Rent unit and rents it to a low-income household at no more than the High HOME Rent.
- The owner then redesignates Unit 106 as a non-assisted unit.

Scenario 2:

It is Year 7 of the affordability period. There has been substantial turnover at the property, but the property is in compliance with the HOME unit mix requirements. On several previous occasions, in order to maintain compliance in the property, the owner chose to substitute a "greater" 2-bedroom unit for a 1-bedroom unit where the tenant was over-income. As a result, the current unit mix is as follows:

- 1 BR units – 3 High HOME Rent units, 7 non-assisted
- 2 BR units—3 Low HOME Rent units, 4 High HOME Rent units, 3 non-assisted

Attachment 4-A: Calculating Adjusted Household Income for the Purpose of Establishing Rent

Owners/Managers must use a tenant's *adjusted* household income to determine rent when:

1. The PJ requires owners/managers to use the adjusted income option for determining the rent for very low-income tenants of Low HOME Rent units (discussed in Section 3.2.B); or
2. The income of a tenant occupying a HOME-assisted unit exceeds the low-income limit. Sections 4.3 and 4.4 discuss over-income tenants occupying HOME-assisted units for properties with fixed and floating HOME units, respectively. Section 2.5 explains how to determine tenant income-eligibility.

The adjusted income method is used *only* for the purposes of determining rent. It is *never* used for verifying a tenant's annual income for purposes of establishing income-eligibility. 24 CFR Part 5, Subpart F, establishes the requirements for determining adjusted income.

Adjusted household income is determined by subtracting specific deductions, or allowances, from a household's annual gross income.

Adjusted family income is derived by subtracting from a household's annual gross income any of the following five deductions that apply to the household. These deductions are also called allowances.

- **Dependent Deduction.** \$480 for each dependent. This includes any of the following family members who are not the head of household or spouse: persons under 18, family member with a disability, or full-time students;
- **Child Care Expenses Deduction.** Reasonable child care expenses for children 12 and under during the period for which annual income is computed that enable a family member to work or go to school, if no adult is available in the household to provide child care;
- **Medical Expenses Deduction.** For elderly households only, medical expenses, including medical insurance premiums, in excess of three percent of annual income that are anticipated during the period for which annual income is computed and that are not covered by insurance;
- **Disability Assistance Expenses Deduction.** Reasonable expenses in excess of three percent of annual income for the apparatus and care of a family member with a disability that enables that person or another person to work that are anticipated during the period for which annual income is computed; and
- **Elderly or Disabled Household Deduction.** \$400 for any elderly family. An elderly family is one where the head of household or spouse is 62 or older or has a disability.

Chapter Four of HUD's *Technical Guide for Determining Income and Allowances for the HOME Program Third Edition (HUD-1780-CPD January 2005)*, provides detailed guidance on each of these deductions, and how to calculate adjusted income. This guide is available at no cost from Community Connections, at 800-998-9999.

For up-to-date rules and requirements for determining adjusted income, consult 24 CFR Part 5 Subpart F.

Chapter 5: Finding and Keeping Tenants

5.1. Overview

PJs must instruct owners and managers on how to ensure that all households have fair and equal access to HOME-assisted housing and that tenants are treated fairly and equitably. This chapter reviews the nondiscrimination, affirmative marketing, and tenant selection requirements of the HOME Program and identifies required lease provisions and prohibited lease terms that protect tenants' rights.

5.1.A. Finding and Keeping Tenants: Summary of HOME Requirements

Owners/Managers of HOME-assisted housing must comply with all **fair housing laws**, which prohibit discrimination in housing based on race, color, religion, sex, familial status, national origin, age, and disability.

The PJ must develop affirmative marketing procedures for properties with five or more HOME-assisted units, to ensure that owners/managers conduct special outreach to those groups least likely to apply for the HOME-assisted housing. **Accessible units** in HOME-assisted properties must be offered first to persons with disabilities.

Owners and managers of HOME-assisted properties must treat applicants and tenants fairly and equitably by:

- Establishing and following standard **tenant selection procedures**;
- Using leases that protect tenants' rights; and
- Using established procedures to resolve conflicts with tenants.

In addition, when community housing development organizations (CHDOs) own and manage HOME-assisted properties, the CHDO must have a plan in place that ensures **tenant participation** in property operations.

5.2. Marketing

Owners of HOME-assisted rental housing and their property managers must conduct marketing and advertising activities in accordance with applicable fair housing laws, as well as specific HOME requirements that relate to affirmative marketing. These fair housing and affirmative marketing requirements ensure that owners and managers provide the opportunity to rent HOME-assisted units to *all* eligible applicants. In addition, owners and managers must take certain additional steps to make accessible units available to persons with disabilities.

5.2.A. Nondiscrimination in Housing

Federal fair housing laws prohibit discrimination in housing based on a person's race, color, religion, sex, familial status, national origin, age, and disability.

Fair housing laws prohibit discrimination in all housing, housing-related activities, and housing programs regardless of whether or not the housing receives Federal financial assistance. Owners and managers cannot discriminate in the rental of units, in establishing terms and conditions of property rentals, or in advertising the availability of rental housing units.

Tips for PJs: Nondiscrimination in Housing

In addition to the Federal fair housing and nondiscrimination laws, most states and many local jurisdictions also have fair housing and civil rights laws and statutes. The PJ should notify owners and managers of any additional fair housing requirements based on state or local law.

See HUD's online, interactive training module, *HOME Cross-Cutting Federal Requirements*, or the HOME model program guide *Fair Housing for HOME Program Participants*. Both resources are available on HUD's HOME Program web page at www.hud.gov/homeprogram.

5.2.B. Affirmative Marketing Requirements

PJs must develop affirmative marketing procedures for properties with five or more HOME-assisted units. Affirmative marketing procedures ensure that special outreach and advertising efforts are made to communicate the availability of HOME-assisted housing to those groups or individuals that might otherwise be unlikely to apply for it. Affirmative marketing should be made part of the property's overall marketing activities.

Tips for PJs: Affirmative Marketing

Affirmative Marketing Procedures

The PJ must establish the affirmative marketing procedures that owners of each HOME-funded property with five or more HOME-assisted units must follow. (Note: State PJs may permit their state recipients to develop these procedures.) The PJ's affirmative marketing procedures must clearly state what actions owners/managers must take to provide information to and otherwise attract eligible persons in the housing market area to available housing without regard to race, color, religion, sex, familial status, national origin, age, or disability. The extent of the affirmative marketing activities generally varies depending on the size of the property. The PJ's procedures may vary from property to property and are likely to vary from neighborhood to neighborhood.

The PJ's procedures must state:

- Methods the PJ will use to inform the public, owners, and potential tenants about fair housing laws and the PJ's affirmative marketing policies (for example, use of the Fair Housing logo);
- What actions owners and/or the PJ must take to notify persons not likely to apply for HOME-assisted housing without special outreach of housing opportunities (for example, distribute flyers about a property, or advertise in foreign language community newsletters or newspapers);
- What records the owner/PJ must maintain to document actions taken to affirmatively market units and to assess the effectiveness of the marketing procedures; and
- How affirmative marketing efforts will be assessed and what corrective actions will be taken where requirements are not met, or where the property does not achieve the desired results.

The PJ should communicate the owners' responsibilities clearly:

- Owners are responsible for carrying out affirmative marketing activities for their properties. Owners can delegate affirmative marketing activities to a property manager but the owner remains responsible for compliance with the PJ's requirements.
- Owners should retain a written description of how they will carry out the affirmative marketing activities required by the PJ on file in the property management office, and make it available for review by the PJ or HUD. The owner's file should include a copy of the PJ's procedures and/or a plan that is customized to reflect the specific circumstances of the property.

PJs can participate in affirmatively marketing units, such as distributing notices and flyers to program offices and other public agencies.

Assessing the Effectiveness of Affirmative Marketing

The PJ must assess the success of its affirmative marketing procedures on an annual basis. The PJ should identify what records or reports it will need from the owner to assist in its evaluation efforts. This is generally found in the written agreement between the PJ and the owner. In the event the PJ determines the affirmative marketing requirements are not met, or anticipated results are not achieved, the PJ may need to take corrective actions.

5.2.C. Marketing Accessible Units

Owners/Managers of properties with accessible units must develop procedures to ensure that information regarding the availability of those units reaches eligible individuals with disabilities. Reasonable, nondiscriminatory

steps must be taken to make sure that available, accessible units are offered first to persons with disabilities who require the units' accessibility features.

PJs must be sure that owners/managers understand and take the following required steps when an accessible unit becomes vacant, regardless of the status of the waiting list:

- First, offer the unit to a current occupant of the property who might require or benefit from the accessibility feature(s) of the unit;
- Second, offer the unit to an eligible qualified applicant on the waiting list who requires the accessibility feature(s) of the unit; and
- Last, offer the unit to a non-disabled person on the waiting list.

A non-disabled tenant may rent an accessible unit only when the owner/manager has made all reasonable efforts to attract a tenant with a disability, and has followed the above steps.

Tips for PJs: Marketing Accessible Units

When a non-disabled tenant leases an accessible unit, HUD strongly encourages PJs to ask or require property owners to include a special provision in the tenant lease. This provision would require the non-disabled family to move into a non-accessible unit of the same size if a family that requires the accessible features of their unit applies and is eligible for the unit.

For additional information about providing housing in accordance with laws that protect persons with disabilities, see HUD's Office of Fair Housing and Equal Opportunity web page at <http://www.hud.gov/offices/fheo/disabilities/sect504.cfm>.

5.3. Tenant Rights and Protections

PJs must ensure that owners develop tenant selection policies and criteria to ensure that all applicants and tenants are treated fairly and equitably.

The HOME Program protects tenant rights in a number of ways:

1. Every tenant must have a written lease;
2. The lease term must be for at least twelve (12) months, unless otherwise approved by the PJ;
3. The lease term may never be for less than 30 days;
4. The HOME Program specifies certain prohibited lease clauses; and
5. The PJ must approve all leases.

For properties that are owned, developed, or sponsored by community housing development organizations (CHDOs), the property must have a tenant participation plan to ensure that tenants are involved in the management and decision-making of the property. CHDO properties must also have fair lease and grievance procedures.

5.3.A. Tenant Selection Procedures

The owner/manager is responsible for establishing tenant selection procedures. These procedures describe the methods and procedures for taking applications and screening tenants at the property. These requirements are found in 24 CFR 92.253(d). Tenant selection procedures must:

- Be consistent with the purpose of providing housing for low-income and very low-income families;
- Be reasonably related to HOME Program eligibility and the tenant's ability to perform the obligations of the lease;
- Provide for the selection of tenants based on a written waiting list in the chronological order of application, to the extent practicable; and
- State that the owner or manager will give prompt written notice to any rejected applicant, with an explanation of the grounds for the rejection.

Elements of the Tenant Selection Procedures

The following are the required and recommended elements of tenant selection procedures:

- Tenant selection procedures should identify the criteria that will be used to select tenants.
 - Tenants should be selected based on *objective* criteria, related solely to program qualification and ability to pay the rent and abide by the terms of the lease. These criteria might include household income, housing history, credit history, and/or lack of criminal record. Property owners/managers must apply the criteria consistently to all applicants, in accordance with fair housing laws.
 - Tenant selection criteria should expressly prohibit bias in the selection process including discrimination or favoritism toward friends or relatives, or other situations in which there may be a conflict of interest.
 - Tenant selection criteria can give preference to persons with special needs only if the PJ has so directed.
- Tenant selection procedures must state that owners/managers will promptly notify an applicant in writing if he/she has been rejected, and will explain the grounds for the rejection. (This is a required element.)
- Owners/Managers must maintain a written waiting list and must select tenants in the chronological order of application, to the extent practicable. The tenant selection procedures should describe how the waiting list will be maintained. (This is a required element.)
- The tenant selection procedures should describe the HOME requirements that affect tenants and tenant selection in terms that are clear and easy to understand. Specifically, the procedures should describe:
 - How vacant units will be filled;
 - HOME unit occupancy requirements;
 - Nondiscrimination policies and the affirmative marketing procedures, including accessibility requirements;
 - Marketing strategy for accessible units;
 - Tenant selection records that must be maintained; and
 - CHDO tenant participation plan, if applicable.

Tips for PJs: Tenant Selection Procedures

PJs should offer guidance to owners/managers on how to develop tenant selection procedures that are fair and equitable to all applicants. PJs can use the checklist above to verify that a property's tenant selection procedures are appropriate and compliant.

Selection Preferences for Tenants with Special Needs

In certain circumstances, the PJ can authorize a property owner to give preference in the tenant selection process for persons with special needs (such as the elderly or persons with disabilities). This preference must be identified in the PJ's Consolidated Plan. The Consolidated Plan must document that the special needs group getting preference has an unmet housing need and demonstrate that the preference is necessary to narrow the gaps in benefits and services to the special needs group.

Generally, PJs cannot specify a preference for persons with a *specific type* of disability. Although HOME funds can be used to assist housing that gives a preference for persons with disabilities generally, civil rights laws (which confer certain protections on persons with disabilities) in most cases prohibit owners from discriminating based upon the nature of a disability. Consequently, HOME-assisted housing for persons with disabilities must be equally available to *all* persons with disabilities. Owners/Managers may offer and advertise non-mandatory services that may be appropriate for persons with a particular special need or disability.

Note, the only exception to this rule is for housing for persons with a specific type of disability who could not reside in housing that is available to the general public. In practice, this exception would apply to persons whose disabilities require them to have on-site supportive services (such as 24-hour supervision), because without the on-site services, these persons would be unable to maintain themselves in housing. See 24 CFR 8.4(b)(1)(iv).

5.3.B. Reasonable Accommodations for Persons with Disabilities

The Fair Housing Act generally requires that all applicants and tenants of rental housing be given equal treatment and prohibits discrimination against anyone with respect to race, color, religion, sex, disability, familial status, or national origin. In general, the Fair Housing Act requires applicants to be treated equally. However, there are limited circumstances when the Act requires a housing provider to treat persons with disabilities differently, to enable them to have equal access to, or enjoyment of, housing and other housing-related programs. Specifically, the Fair Housing Act requires housing providers to provide "reasonable accommodations" to persons with disabilities. This means an owner may have to modify rules, policies, practices, procedures, and/or services to afford a person with a disability an equal opportunity to use and enjoy the housing.

5.3.C. Tenant Rights and Protections

HOME imposes several requirements to protect tenants' rights:

- **Owners must execute a written lease** with tenants of HOME-assisted units. Note that program service agreements and personal responsibility agreements are not leases.
- **The lease term must be for at least one year**, unless the owner/manager and the tenant mutually agree to a shorter period. If the tenant has agreed to a different lease term, that agreement should be noted in writing in the tenant's file. A lease may *not* be for a period less than 30 days.

-
- **Leases must clearly state that the owner/manager reserves the right to adjust tenant rents**, in accordance with the HOME rent limits and in the event a tenant's income increases above the low-income or very low-income limits, for the unit type (High HOME Rent or Low HOME Rent) the tenant occupies. These requirements are described in Chapters 2, 3, and 4.

Terminating the Lease

Owners/Managers can only terminate the tenancy or refuse to renew the lease of a tenant of a HOME-assisted unit for good cause. Good cause includes:

- Serious or repeated violation of the terms and conditions of the lease;
- Violation of applicable Federal, state, or local law;
- Completion of the tenancy period for transitional housing; or
- Other good cause, as defined by the lease.

An increase in tenant income is *not* considered good cause and an owner/manager cannot terminate or refuse to renew a lease because a tenant is over-income. Chapter 4 describes steps an owner must take when a tenant becomes over-income.

When good cause exists, an owner/manager may terminate or refuse to renew tenancy by:

- Serving written notice upon the tenant at least 30 days before the termination of tenancy. This notice must specify the grounds for the termination or refusal to renew the lease.
- Documenting the property files with a justification for terminating the lease and a copy of the 30-day written notice to the tenant.

Prohibited Lease Provisions

HOME further protects tenant rights by prohibiting the following lease clauses:

- **Agreement to be sued.** Agreement by the tenant to be sued, admit guilt, or consent to a judgment in favor of the owner in a lawsuit brought in connection with the lease.
- **Agreement regarding seizure of property.** Agreement by the tenant that the owner may take, hold, or sell personal property of household members without notice to the tenant and a court decision on the rights of the parties. This prohibition does not apply to an agreement by the tenant concerning disposition of personal property remaining in the unit after the tenant has moved out. The owner may dispose of personal property in accordance with state law.
- **Agreement excusing the owner from responsibility.** Agreement by the tenant not to hold the owner or the owner's agents legally responsible for actions or failure to act, whether intentional or negligent.
- **Waiver of notice.** Agreement by the tenant that the owner may institute a lawsuit without notice to the tenant.
- **Waiver of legal proceedings.** Agreement by the tenant that the owner may evict the tenant or household members without instituting a civil court proceeding in which the tenant has the opportunity to present a defense or before a court decision on the rights of the parties.
- **Waiver of a jury trial.** Agreement by the tenant to waive any right to a jury trial.
- **Waiver of right to appeal a court decision.** Agreement by the tenant to waive the tenant's right to appeal or otherwise challenge in court a decision in connection with the lease.
- **Agreement to pay legal costs, regardless of outcome.** Agreement by the tenant to pay attorney fees or other legal costs even if the tenant wins the court proceeding by the owner against the tenant. The tenant, however, may be obligated to pay costs if the tenant loses.

Tips for PJs: Tenant Rights and Protections

The PJ must approve a property's lease and specific HOME rents for that unit type and bedroom size, prior to lease execution. PJs can use Attachment 7-A, *Checklist to Verify that the Lease Conforms to HOME Requirements*, to review tenant leases. This attachment is located at the end of this chapter.

In addition to the HOME requirements, tenant leases must also comply with state or local tenant-landlord laws. Many jurisdictions have tenant-landlord organizations or mediators with expertise in state and local law. PJs should become familiar with these organizations, and make this information available to owners/managers, as needed.

5.3.D. Dispute Resolution

Owners and managers of HOME-assisted rental properties should have written procedures in place that address the following situations:

- Disputes between individual tenants or households; and
- Tenant grievances against management.

Tips for PJs: Dispute Resolution Procedures

Generally, it is acceptable business practice for the owner to act as the first intermediary in a conflict under limited circumstances, such as when one tenant complains about noise from another tenant's unit. However, PJs should encourage owners/managers to establish an impartial way to address complaints about property management staff or the way in which the property is being operated. This generally requires the involvement of a neutral third party.

5.3.E. Tenant Relations in CHDO Projects

When housing is owned, developed, or sponsored by a CHDO, the owner must:

- Establish and implement a plan for tenant participation in management decisions, and
- Establish a fair lease and grievance procedure. The PJ must approve this procedure.

These requirements are found at 24 CFR 92.303.

Tenant Participation in Management

Tenant participation in management decisions can be achieved in a number of ways. Two common options are:

- Involvement of a tenant association to act as a formal body to provide input for project management; or
- Tenant election of a representative who acts as a liaison with management.

Fair Lease and Grievance Procedures

Fair lease and grievance procedures should be objective. They should clearly state:

- To whom a tenant should direct a complaint;
- Who will investigate and/or respond to the complaint; and
- By when the tenant should expect to receive a response.

Tips for PJs: Tenant Relations in CHDO Projects

The fair lease and grievance procedures must be approved by the PJ. The PJ should review the procedures to ensure that the CHDO has established a fair and equitable process for addressing tenant or prospective tenant concerns, particularly as they relate to property management staff and how the property is managed.

Tenants should have an impartial process for pursuing resolution to disputes. The PJ might want to consider a requirement that all responses to complaints be made in writing, with a copy sent to the PJ.

Attachment 5-A: Checklist to Verify that the Lease Conforms to HOME Requirements

Owners must be sure that the following provisions *are* included in a lease for a HOME-assisted unit:

Yes / No	Required Provision	Description
	Income Eligibility/Annual Income Recertification	<ul style="list-style-type: none"> • Owner retains right to recertify the tenant's HOME income-eligibility on an annual basis. The tenant's failure to cooperate in the income recertification process constitutes a violation of the lease. • Deliberately providing false information can result in termination of the lease.
	HOME Rent Restrictions/Rent Increases	<ul style="list-style-type: none"> • Rents are subject to the rent restrictions of the HOME Program. Owner retains right to adjust rents, in accordance with the HOME Rent limits. The rents for tenants whose incomes go over the HOME rent limits for the units they occupy (High or Low HOME Rent units) will be increased. • Terms for rent increases (i.e., how frequently rent can be increased; when increases can be made; how much written notice must tenant receive).
	Lease Renewal	<ul style="list-style-type: none"> • Owner may choose not to renew a tenant's lease for good cause, and definition of good cause. • Owner must give the tenant a written notice at least 30 days before the tenant must vacate the unit.
	Lease Term	<ul style="list-style-type: none"> • The lease term for a HOME-assisted unit must be for at least one year, unless the tenant and the owner mutually agree upon a shorter term.
	Annual Unit Inspection	<ul style="list-style-type: none"> • Owner retains the right to inspect, and to permit the PJ and HUD to inspect, HOME-assisted units during the affordability period. State or local law may establish how much notice the tenant must be given for inspections.
	Accessible Units	<ul style="list-style-type: none"> • Owners may choose to include a provision in the lease of a tenant that occupies, but does not have need for, an accessible unit. This provision would give the owner the right to ask the tenant to move into a comparable non-accessible unit, should the accessible unit be needed by a person with a disability.
	Lead Warning Statement, for properties built prior to 1978	<ul style="list-style-type: none"> • Confirm that the owner has complied with lead-based paint notification requirements.

Attachment 5-A: Checklist to Verify that the Lease Conforms to HOME Requirements*(continued)*

Prohibited Lease Provisions

Owners must be sure that the following provisions *are not* included in a lease for a HOME-assisted unit. These provisions are prohibited by the HOME regulations at § 92.253:

Yes / No	Prohibited Provisions	Description
	Agreement to be sued	<ul style="list-style-type: none"> Agreement by the tenant to be sued, to admit guilt, or to a judgment in favor of the owner in a lawsuit brought in connection with the lease.
	Agreement regarding seizure of property	<ul style="list-style-type: none"> Agreement by the tenant that the owner may seize or sell personal property of household members without notice to the tenant and a court decision on the rights of the parties. This provision does not apply to disposition of personal property left by a tenant who has vacated a property.
	Excusing owner from responsibility	<ul style="list-style-type: none"> Agreement by the tenant not to hold the owner or the owner's agents legally responsible for any action or failure to act, whether intentional or negligent.
	Waiver of notice	<ul style="list-style-type: none"> Agreement of the tenant that the owner may institute a lawsuit without notice to the tenant.
	Waiver of legal proceedings	<ul style="list-style-type: none"> Agreement of the tenant that the owner may evict the tenant or household members without instituting a civil court proceeding in which the tenant has the opportunity to present a defense, or before a court decision on the rights of the parties.
	Waiver of a jury trial	<ul style="list-style-type: none"> Agreement by the tenant to waive any right to a trial by jury.
	Waiver of right to appeal court decision	<ul style="list-style-type: none"> Agreement by the tenant to waive the tenant's right to appeal or to otherwise challenge in court a court decision in connection with the lease.
	Agreement to pay legal costs, regardless of outcome	<ul style="list-style-type: none"> Agreement by the tenant to pay attorney's fees or other legal costs, even if the tenant wins in a court proceeding by the owner against the tenant. The tenant, however, may be obligated to pay costs if the tenant loses.

Chapter 6: Maintaining the Physical Asset

6.1. Overview

PJs must be sure that project owners understand the property standards requirements of the HOME Program. This chapter reviews the property standards requirements for HOME-assisted housing, including the standards for accessible units and the lead-based paint rules. This chapter also reviews good practices for managing the physical aspects of the property.

6.1.A. Maintaining the Physical Asset: Summary of HOME Requirements

The HOME Program establishes **minimum property standards** by HOME activity (new construction, acquisition, or rehabilitation). In addition, owners/managers must comply with rules related to **controlling or abating the hazards of lead-based paint**. In properties that are constructed prior to 1978, the rules require:

- Certain **disclosures** to applicants and tenants about any known or potential lead-based paint hazards; and
- **Ongoing maintenance** to monitor controls put in place to limit hazards associated with the presence of lead-based paint.

Accessible units in a HOME-assisted property must conform to the **Uniform Federal Accessibility Standards (UFAS)** throughout the affordability period.

In order to protect its HOME investment in the event of property damage or personal injury, and to limit the PJ's financial liability, it is prudent for PJs to require or request owners to secure insurance. Insurance is not required by the HOME Program.

6.2. Property Standards

HOME-assisted rental properties must meet the HOME property standards, including rules related to the control and abatement of lead-based paint and the Uniform Federal Accessibility Standards (UFAS) for accessible units. Applicable rules related to property standards apply for the entire affordability period, regardless of who manages the property, when the HOME-assistance is repaid, and/or whether the property's ownership is transferred.

6.2.A. HOME Minimum Property Standards

Exhibit 6-1 identifies the HOME minimum property standards. Applicable standards are based on the type of HOME activity.

Exhibit 6-1: Minimum Property Standards by Activity Type

Activity	Minimum Property Standard to be Met
Acquisition of existing rental housing (no rehabilitation or construction)	Applicable state or local housing quality standards and code requirements. If no local standards/codes apply, Section 8 Housing Quality Standards.
Rehabilitation of rental housing	Local written rehabilitation standards. AND State and local code requirements. If no local codes apply, one of the following national model codes: ² <ul style="list-style-type: none"> • Uniform Building Code (ICBO) • National Building Code (BOCA) • Standard Building Code (SBCCI) OR <ul style="list-style-type: none"> • Council of American Building Officials one- or two-family code (CABO) OR <ul style="list-style-type: none"> • Minimum Property Standards* at 24 CFR 200.925 or 200.926 (FHA). AND Uniform Federal Accessibility Standard for accessible units, as applicable.
New construction of rental housing	State and local code requirements. If no state and local codes apply, one of the following national model codes: <ul style="list-style-type: none"> • Uniform Building Code (ICBO) • National Building Code (BOCA) • Standard Building Code (SBCCI) OR <ul style="list-style-type: none"> • Council of American Building Officials one- or two-family code (CABO) OR Minimum Property Standards (FHA) at 24 CFR 200.925 (for multi-family) or 200.926 (for one- and two-unit dwellings). AND International Energy Conservation Code. ³ AND Uniform Federal Accessibility Standard for accessible units, as applicable.

² Since the promulgation of the HOME Program regulations, these code issuing agencies have merged to form the International Code Council (ICC). The model codes used for the HOME Program are no longer being updated. In their stead, the ICC has issued the International Building Code. HUD will consider whether changes to the HOME regulations incorporating the International Building Code are appropriate. The HOME Program web page provides updated information on all HOME requirements. (See <http://www.hud.gov/offices/cpd/affordablehousing/programs/home/index.cfm>.) For more information about the International Building Code, see www.iccsafe.org.

³ Since the promulgation of the HOME Program regulation, the Model Energy Code published by the Council of American Building Officials (CABO) cited at 92.251(a)(1) was renamed/replaced by the International Energy Conservation Code issued by the International Code Council (ICC), following the merger of CABO and the ICC.

Property Standards during the Affordability Period

HOME-assisted rental housing must meet the required property standards at the time of project completion and must be maintained in accordance with applicable housing quality standards throughout the affordability period.

Tips for PJs: HOME Minimum Property Standards

The PJ can adopt more stringent local property standards than those imposed by the HOME Program. The PJ should specify all property standards and codes that apply to a property in its written agreement with the owner.

PJs are required to inspect all HOME-assisted rental properties and units on a periodic basis to ensure that they meet the applicable housing quality standards and requirements. Chapter 7 discusses these property inspections in more detail. When the property fails to meet the applicable standards, the PJ must require the owner to take corrective actions, such as making repairs to the property to bring it up to applicable codes or standards. If the deficiencies are serious or result from poor property management, the PJ may also require the owner to replace the property manager or repay the HOME investment, if it has reserved the right to do so in its written agreement with the owner.

In project underwriting, and in project monitoring during the affordability period, PJs should verify that the owners have adequately budgeted for maintenance and major systems repairs, as needed. Additional HOME funds may be invested in a HOME-assisted property only within the first twelve months of project completion. Thereafter, a PJ may not provide additional HOME funds to a HOME-assisted property during the affordability period.

If property standards change during the period of affordability, the PJ must communicate how the new standards apply to the owner.

6.2.B. Ongoing Lead-Based Paint Requirements

The PJ must be sure that owners understand their lead-based paint disclosure and ongoing maintenance obligations.

Disclosure Requirements

Prior to leasing a unit, owners of pre-1978 rental properties must:

- Provide prospective tenants the lead hazard information pamphlet, *Protect Your Family from Lead in Your Home*. The PJ should provide this pamphlet, issued by the U.S. Environmental Protection Agency, to the owner. It is available online at www.hud.gov/offices/lead/outreach/leapame.pdf.
- Disclose any known lead or lead hazards in the property, including the location of lead-based paint and/or lead hazards, and the condition of the painted surfaces. The PJ should provide the owner with a sample disclosure form. It is available online at www.hud.gov/offices/lead/disclosurerule/index.cfm.
- Provide to the prospective tenant any records and reports on lead-based paint and/or lead-based paint hazards which are available to the owner, including records and reports concerning common areas and other units, when such information is obtained as a result of a building-wide evaluation; and
- Attach to the lease, or insert language in the lease, a *Lead Warning Statement* that confirms the owner has complied with all notification requirements. If an attachment is used, owners and tenants must sign and date the attachment.

Ongoing Maintenance

Owners must provide ongoing maintenance to pre-1978 properties if interim controls were used in the property. This involves:

- **Visual assessment** of the unit to identify deteriorating paint or failed hazard reduction measures. Visual assessments must be conducted by people trained in visual assessment. HUD offers a one-hour online training for visual assessment, available at: <http://www.hud.gov/offices/lead/training/visualassessment/h00100.htm>.
- **Lead hazard reduction** if the visual assessment identifies any deteriorated paint or failed hazard reduction measures. These must be addressed by workers trained in lead-safe work practices. For information on training in lead-safe work practices, see: <http://www.hud.gov/offices/lead/training/index.cfm>.
- **Clearance.** Clearance involves dust sampling to ensure that no dangerous dust hazards were created by the lead hazard reduction work. After work is complete, it must pass clearance. A certified risk assessor, paint inspector, or lead sampling technician must conduct clearance.
- **Notification.** The owner/manager must inform tenants of any work done with a Notice of Lead Hazard Reduction. The PJ should provide a sample notice to the owner. One is available online at: www.hud.gov/offices/cpd/affordablehousing/training/leadsafe/keyrequirements/reducsample.pdf.
- **Record-Keeping.** HOME requires that records of inspections, repairs, lead hazard reduction, clearance, and notification activities be kept for at least three years after the activities cease. It is recommended that the records be kept indefinitely.

Tips for PJs: Lead-Based Paint Requirements

Since the lead-based paint requirements are relatively new, it is especially important to be sure that owners understand what is required and have access to information about contractors who are trained in lead-safe work practices.

To learn more about lead-based paint requirements, refer to the online training modules on HUD's web page *Lead Safe Housing Rule* at www.hud.gov/offices/cpd/affordablehousing/training/leadsafe/index.cfm or from HUD's Office of Healthy Homes and Lead Hazard Control web page at www.hud.gov/offices/lead.

6.2.C. Standards for Accessible Units

Owners/Managers of certain HOME-assisted rental properties are required to provide units that are accessible for persons with mobility or sensory impairments.

Maintaining Accessible Units

For properties that have units that are accessible to persons with mobility and/or sensory impairments, these units must be maintained as accessible units throughout the affordability period. This means that the units must meet the Uniform Federal Accessibility Standards (UFAS) during this time.

In addition to property standards for accessible units, there are also specific marketing steps to maximize the opportunity for persons with disabilities to rent accessible units. These steps are described and discussed in Chapter 5.

For more information about UFAS, refer to the Uniform Federal Accessibility Standards at www.access-board.gov/ufas/ufas-html/ufas.htm.

For more information about fair housing requirements, refer to HUD’s *Fair Housing and Equal Opportunity* web page at www.hud.gov/offices/fheo/FHLLaws/index.cfm.

6.3. Managing the Physical Aspects of the Property

HOME properties are valuable assets. Maintaining the physical condition of the properties helps owners retain the value in their investments, and promotes financial viability. PJs should review owners’ management plans to ensure that the property management adequately addresses the following operational issues:

- Routine and preventive maintenance;
- Property security;
- Work order systems;
- Operating deficit accounts; and
- Capital repairs and improvements.

HUD’s model program guide, *Asset Management: Strategies for the Successful Operation of Affordable Rental Housing* (HUD-2018-CPD, May 2000) provides guidance on managing these aspects of HOME-assisted properties. This guide can be ordered from Community Connections at 1-800-998-9999.

6.3.A. Routine and Preventive Maintenance

HOME-assisted properties need routine preventive maintenance. The property owner should have a schedule for preventive maintenance on a regular, seasonal, and/or annual basis. Routine maintenance problems should be addressed in order of priority as expeditiously as possible. Deferred maintenance often leads to more costly repairs in the future.

PJs should be on the lookout for signs of property decline in its inventory. Exhibit 6-2 lists early warning signs of property decline.

Exhibit 6-2: Warning Signs for Property Decline

Warning signs that a property may be declining, or property standards are not being met include:

- Increasing tenant complaints;
- Frequent tenant turnover;
- Deferred maintenance or repair items;
- Increasing crime; and
- Code violations.

6.3.B. Property Security

Adequate security is needed to protect the safety of the tenants and protect the property, to the greatest extent feasible. Security steps might include:

- Maintaining doors, windows, locks, and building entry systems;
- Providing and maintaining adequate lighting;
- Ensuring the integrity of fences and barriers; and
- Providing thoughtful landscaping and structural attributes that enhance a tenant’s visibility to and from exterior doorways to prevent hiding places for unwanted visitors.

6.3.C. Work Order Systems

The property's work order system should identify and track work requests that are brought to the property manager's attention. The property owner/manager must be able to prioritize work that needs to be done in a flexible schedule. The system should distinguish urgent and routine requests. All legitimate work requests should be filled in a timely manner.

The property manager should maintain a work order system that records:

- Who requested the work to be done;
- Location of the problem;
- Nature of the problem;
- Who is assigned to complete the work;
- What was done to solve the problem;
- Time it took for the problem to be resolved; and
- Cost of materials used in making the repair.

6.3.D. Operating Deficit Account

An initial operating deficit reserve is used to meet any shortfall in the property during the rent-up period, when revenues can be unpredictable and costs are steady. Such reserves are a prudent step for the start-up period.

PJs should consider funding an operating deficit account. HOME funds can be used to cover the cost of funding a rental housing property's initial operating deficit reserve for new construction and rehabilitation projects. The reserve cannot exceed 18 months and can only be used for project operating expenses, scheduled payments to replacement reserve accounts, and the property's debt service.

6.3.E. Capital Repairs and Improvements

Adequate and timely attention to capital repairs will ensure the property's long-term physical viability. If unprepared, the financial cost of a major systems failure in the property can cause a significant financial strain on a property. PJs should be sure owners establish adequately-funded reserve accounts to prepare for this type of financial emergency. By calculating the estimated useful life of all of the property's systems and equipment, owners/managers can determine the amount of funds that must be deposited in the property's replacement reserve account. Effective budgeting for capital repairs and improvements is critical to ensure that all of the property's capital needs are addressed on a timely basis.

At a minimum of every three years, but more frequently if practicable, the property manager should:

- Compile or review a list of all of the property's building components/systems;
- Identify the item's or system's installation or replacement date;
- Determine the estimated useful life of the item or system;
- Estimate the cost to replace the item in today's dollars; and
- Determine the cost of replacing the item at the estimated replacement date.

HOME funds cannot be used to fund a replacement reserve account. However, if any HOME funds placed in an operating deficit account (described above) remain unexpended at the end of the 18-month period, these funds may be retained for capital repairs or other project reserves, if permitted by the PJ.

6.4. Property Insurance

Property insurance is not required by the HOME Program. However, carrying property insurance is a good business practice and is often required by the lender. If not, the PJ should consider imposing this requirement. Insurance protects the property and parties involved in the event of unforeseen circumstances. In general, PJs should review owners' property management plans with an eye for minimizing risks at the property and keeping tenants safe from crime, health hazards, and injuries.

6.4.A. Minimizing Risk

Generally, there are two types of risks of concern to owners, lenders, and PJs:

- Hazards that pose a danger to the property structure; and
- Hazards that pose a danger to individuals. Generally, the property owner is liable for certain injuries sustained by tenants and their guests.

Types of Insurance for a Rental Properties

Several types of insurance protect rental properties, including hazard, liability, and workers' compensation.

- **Hazard insurance** covers property damage caused by fire, wind, storms, and other similar risks.
- **Liability insurance** protects property owners against claims that the owner or manager was negligent or did something inappropriate that resulted in injury or property damage to another person.
- **Workers compensation insurance** is necessary if the property owner employs other people in the management of the property. This protects property owners against claims for work-related injuries or death.

Tips for PJs: Insurance

The PJ should see that the owner maintains a safe and secure property and should recommend or require the owner to secure insurance.

PART II

THE PJ'S ROLE IN ENSURING LONG-TERM COMPLIANCE

PJ involvement during the affordability period can heavily influence the long-term compliance and viability of HOME projects. Part II explores the PJ's monitoring function, and emphasizes the importance of the PJ's early intervention when things go wrong.

Chapter 7: Monitoring for HOME Compliance and Financial, Physical, and Managerial Viability

7.1. Overview

This chapter summarizes the PJ’s monitoring obligations and discusses best practices for monitoring HOME projects during the period of affordability. It introduces a comprehensive approach to monitoring called “enhanced monitoring.” Enhanced monitoring involves assessing a property’s compliance with HOME requirements and evaluating its ongoing financial, physical, and managerial viability during the HOME period of affordability.

This chapter further describes how the elements of enhanced monitoring can be incorporated into the PJ’s current compliance monitoring activities without creating new tasks or substantial additional effort. It explains how PJs can use the standard monitoring processes—reviews of reports submitted by project owners, reviews of on-site records, and inspections of properties and units-- to carry out an enhanced monitoring strategy. The chapter concludes with a discussion of the steps the PJ can take when it uncovers HOME compliance issues.

7.2. Enhanced Monitoring: A Comprehensive Approach

This section introduces the concept of enhanced monitoring, which enables the PJ to have a broad perspective on the financial, physical, and managerial viability of the property. It explains what enhanced monitoring is and distinguishes between compliance monitoring and monitoring for long-term project viability.

7.2.A. What is Enhanced Monitoring?

PJs are required to make certain that HOME-assisted rental projects fulfill statutory intent, are implemented in full compliance with the HOME Program regulations, and remain in compliance throughout the affordability period. A combination of annual compliance reports and on-site records review and property inspections are required by regulation. These activities are focused on assessing a project’s compliance and are often referred to “compliance monitoring.”

Why Enhanced Monitoring Is Important

While PJs are required to undertake compliance monitoring to ensure that HOME requirements are met in assisted rental projects, compliance monitoring alone may be insufficient to ensure that assisted rental units continue to provide decent and affordable housing for the required affordability periods. PJs need to ensure that rental units remain physically, financially, and managerially viable during that period for several reasons:

- Often, the earliest signs of problems with a HOME-assisted project appear in financial statements and management practices, even before regulatory compliance problems become detectable.
- Compliance problems may be symptoms of underlying financial, physical, and managerial problems. To fully resolve the compliance issues, PJ staff must understand the underlying financial and physical viability of the project is necessary.

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- Ultimately, if a HOME-assisted rental project fails before the end of the affordability period and can no longer provide affordable housing to low-income tenants, the PJ is responsible to repay HOME funds invested in that project to HUD.

7.2.B. Elements of Enhanced Monitoring

For these reasons, PJs are strongly encouraged to adopt an “enhanced monitoring” approach. When PJs adopt enhanced monitoring, they:

- Build a working relationship with owners through technical assistance activities that ensure that owners and managers are properly trained to carry out their HOME obligations;
- Broaden the scope of their monitoring beyond basic compliance issues to include monitoring for any evidence that the property may be encountering financial, physical, and/or managerial problems that could lead to future noncompliance or even project failure;
- Can identify early warnings about problems in a project that can lead to noncompliance and, with that information are able to intervene before these problems become major and threaten the viability of the project; and
- Adopt internal organizational strategies and procedures to facilitate communication between staff carrying out underwriting, development, technical assistance, and monitoring so that each division of the organization can be fully informed to make improvements in carrying out its function(s).

Weighing Costs and Benefits of Enhanced Monitoring

PJs have limited HOME administrative funds and their HOME rental portfolios grow each year. For many PJs, expanding the scope of PJ rental monitoring activities may not seem practical. However, the technical assistance component of enhanced monitoring can save the PJ time on monitoring and enforcement because property managers will make fewer mistakes and require less PJ time on resolution of compliance findings. The feasibility review activities of enhanced monitoring can be integrated with current annual report review and on-site visit activities, and need not be implemented as separate activities requiring substantial new or additional effort. Finally, in the long run, a PJ can expect less staff time will need to be spent on enforcing compliance and negotiating workouts for distressed rental projects that did not benefit from the early interventions prescribed by enhanced monitoring.

7.2.C. Technical Assistance

By incorporating technical assistance into the PJ’s monitoring strategy, a PJ takes preventive measures to help owners and managers understand and comply with HOME requirements before mistakes are made in the first place.

Traditional PJ monitoring “ensures” compliance with program requirements. PJ monitoring staff looks at an owner’s property management activities after-the-fact, to determine whether or not HOME rules *were* followed in those activities. Problems that are uncovered are to be corrected, with the expectation that the same problems or mistakes will not be repeated.

To comply with HOME rules, property managers must understand them. Property managers need a certain level of expertise to understand how to verify tenant income, calculate rents, use a utility allowance, maintain unit mix, apply affirmative marketing requirements, and maintain properties in accordance with required property standards. Typically, these rental project requirements are established up-front and documented in agreements between the owner or developer. Ultimately, however, they are implemented by a property management staff that may not have been involved in the development process or have access to the agreements. Over time, property management

staff can turn over, placing new and untrained personnel in key compliance roles. Noncompliance can often be attributed more to lack of knowledge than willful neglect.

Technical assistance means putting effort into proactively communicating with property managers about the HOME requirements and property operations before a formal compliance monitoring visit. This training and outreach approach in technical assistance should yield time savings in monitoring and enforcement because well-informed property managers make fewer mistakes. Fewer mistakes result in fewer findings and concerns for PJs to document and follow up when monitoring.

Since the focus is on helping owners and managers to comply, this positive approach may also pay dividends in other aspects of the relationship between the PJ and its property owners and managers. The technical assistance approach cannot replace more formal monitoring. However, when monitoring is applied *only* after the fact, the process can become adversarial because owners and property managers feel compelled to defend their performance, even when they may not have been aware of certain requirements. Further, a smart PJ can use the results of its formal monitoring to tailor its ongoing technical assistance efforts to meet specific project needs.

Exhibit 7-1 provides a range of technical assistance activities the PJ might wish to offer to its owners and managers.

Part I of this guide can be used as the basis for the PJ's technical assistance efforts.

Exhibit 7-1: Sample Technical Assistance Activities

Technical assistance activities might include:

- Offering regularly scheduled compliance training to owners and managers;
- Providing a “manager’s handbook” of materials and tools to help owners and managers achieve compliance. It should include income certification forms, owner reporting forms, file checklists, and the *Technical Guide for Determining Income and Allowances for the HOME Program* (HUD-1780-CPD, January 2005).
- Notifying owners of any relevant HOME training that are offered in the area, and requesting relevant Community Development Technical Assistance (CDTA) trainings through the HUD Field Office;
- Directing owners and managers to the HOME Program web page for a number of valuable tools, including:
 - *Building HOME* training materials, at <http://www.hud.gov/offices/cpd/affordablehousing/training/materials/building/index.cfm>);
 - The income calculator, at <http://www.hud.gov/offices/cpd/affordablehousing/training/web/calculator/calculator.cfm>; and
 - Other sample documents and forms issued and distributed by HUD and posted online on the HOME Program home web page at www.hud.gov/homeprogram.
- Distributing newly issued HOME Program income and rent limits and other HOME rental guidance materials in a timely manner directly to owners *and* managers;
- Contacting and visiting new property owners or property management staff prior to monitoring visits to establish relationships and help the staff understand compliance rules and documentation requirements;
- Giving owners and managers adequate notice and preparation tools in advance of a monitoring visit;
- Helping owners and managers to resolve compliance problems discovered while conducting the reviews; and
- Offering follow-up assistance to owners and managers of properties that have compliance problems.

7.2.D. HOME Compliance Monitoring

When a PJ invests HOME funds in rental housing, it incurs an obligation to monitor the HOME-assisted property to ensure that it complies with the HOME requirements that apply throughout the period of affordability, and to ensure that the property is maintained in accordance with applicable property standards. There are several key HOME compliance areas that the PJ monitors during the affordability period, including: HOME rent limits, HOME income limits, property standards, tenant selection, tenant income verification and recertification, affirmative marketing, tenant leases and protections, and unit mix.

The HOME regulation specifies the minimum compliance monitoring activities that the PJ must undertake:

- **Reporting.** PJs must require owners to submit an annual report on rents and occupancy [24 CFR 92.252(f)(2)]. This report provides data to the PJ on the affordability requirements that limit occupancy to low- and very low-income households and restrict rents to affordable levels.
- **Property Inspections.** PJs must conduct on-site inspections of assisted properties and units to verify that properties are maintained in standard condition and meet applicable housing quality standards, including lead-based paint notification and ongoing maintenance requirements, if applicable. Property and unit inspections must be done every one to three years, depending on the size of the property [24 CFR 92.504(d)(1)]. Exhibit 7-2, below, specifies the frequency of required on-site visits.
- **Record-Keeping.** PJs must maintain sufficient records to enable HUD to determine whether the PJ has met all HOME requirements [24 CFR 92.508(a)] and must impose appropriate record-keeping requirements on for-profit and non-profit developers and their agents to assist the PJ in its obligation to demonstrate HOME compliance [24 CFR 92.504((c)(3)(iv))].
- **Review of Records.** PJs must review records maintained by the owner and/or property manager to verify the accuracy of the owner reports and to ascertain compliance. These on-site visits must also occur every one to three years [24 CFR 92.504(d)(1)]. Exhibit 7-2, below, specifies the frequency of required on-site visits.

Exhibit 7-2: Minimum On-Site Property Inspection Schedule

Total Number of Units in the Property	Minimum Frequency of On-site Inspections
1–4 units	Every three years
5–25 units	Every two years
26 or more units	Every year

These required monitoring activities (reporting, records review, and property inspections) provide the framework for most PJs’ monitoring systems. Beyond these requirements, PJs have considerable discretion to design and plan for monitoring activities to meet local needs. While not required, most prudent PJs develop an annual monitoring plan to guide its monitoring activities. Section 7.3, *The Annual Monitoring Plan and Procedures*, provides guidance on how to develop a monitoring plan. Section 7.4, *Monitoring Activities*, discusses how to monitor for HOME compliance, financial viability, and physical condition through the three key monitoring activities (reporting, records review, and property inspections). It distinguishes what is required for compliance monitoring from what is recommended for enhanced monitoring.

For More Information

For more detailed guidance on the PJ’s monitoring obligations and how to plan for and conduct monitoring, see:

- *Managing HOME* training course. Information about the training course is available at <http://www.icfhosting.com/hcd/cpd/hcdcpd.nsf/webpages/Welcome.html>.
- *Monitoring HOME Program Performance* (HUD 2030-CPD, Oct. 2000). This HOME model program guide contains detailed information about monitoring, including a checklist entitled “Ongoing Monitoring Rental Housing Projects” that can be used to organize records and prepare for a site visit. This guide is available from Community Connections at 1-800-998-9999. An update to this guide is expected in 2009.
- *CPD Grantee Monitoring Handbook, Chapter 7 (HOME)*. This is the monitoring handbook that is used by HUD staff to monitor PJs. It provides detailed checklists about what documents must be retained in PJ and owner

files to demonstrate compliance with HOME. This handbook is available online at <http://www.hud.gov/offices/cpd/library/monitoring/handbook.cfm#7>.

7.2.E. Monitoring for Long-Term Viability

Many difficulties in a rental project first appear in the form of financial problems. For instance, financial reports might reflect a reduction in revenue collections that might be the result of lax rent collection practices on the part of the manager or an increase in unemployment among tenants. Cash flow difficulties might lead to a manager's failure to invest in routine maintenance or replacement reserves, which might, in turn, result in eventual property deterioration. Many of these signs are easily identified and can alert a PJ to emerging problems in a property.

Although asset management tasks are not specifically required by the HOME Program, PJs should be sure that owners conduct asset management. How well asset management is performed ultimately affects the success of a HOME-assisted rental property.

For this reason, monitoring the long-term financial viability of a property is a key component of enhanced monitoring. It is not uncommon for owners to undertake asset management to plan for and track the financial health of their property(ies). Asset management ensures the financial stability of the property and ensures that the property generates sufficient financial return to the owner and investors, if any. (Specific asset management tasks are summarized in Exhibit 7-3.) As part of enhanced monitoring, PJs can require owners to perform a minimum level of asset management and can “piggyback” the owners’ asset management efforts as a relatively easy way to monitor a project’s financial viability. This can be done by requiring owners to submit certain financial reports and management plans to the PJ for review and approval. By making sure that owners conduct effective asset management, the PJ can help track the property’s financial stability and physical condition in the long term. This results in decent housing for occupants, and helps to avoid distress that can result in the loss of properties and repayment of HOME funds.

Exhibit 7-3: Summary of Asset Management Tasks

Asset management entails:

- Preparing operating budgets for properties;
- Determining rents, conducting marketing, and developing management plans;
- Generating financial statements to track the property’s financial performance;
- Securing independent annual audits;
- Reviewing property management’s performance and altering management plans, and/or replacing the property manager, if needed;
- Inspecting the property on a periodic basis;
- Examining maintenance practices and preparing preventive maintenance plans; and
- Undertaking capital planning and planning for physical improvements and/or expenditures of reserves.

Section 7.4 of this guide, *Monitoring Activities*, makes suggestions and recommendations about what specific reports and plans PJs should request or require from owners in order to incorporate an asset management approach to monitoring a property’s long-term viability.

7.2.F. Coordination of Development and Monitoring Activities

As discussed in Chapter 1, the PJ's underwriting activities and the legal agreements it executes with owners impact a project's compliance in the long-run. For truly integrated and effective monitoring, it is important that the PJ also have the organizational structure, management, and procedures to facilitate communication between those who select projects (underwriting and development staff), those who conduct technical assistance (program staff), and those who monitor projects (monitoring staff). This means:

1. Underwriting staff should have access to monitoring reports or other verbal or written communication about the past and current performance of any developer and prior projects;
2. The roles of PJ development and monitoring staff should be clearly articulated during the implementation stage so that all monitoring activities are conducted and coordinated (i.e., construction monitoring, marketing monitoring, and contract administration);
3. The project "hand-off" from development to monitoring staff, if applicable, should take place in a timely manner and with complete communication. Monitoring staff should be fully briefed on the project and should reach out to meet with property management before marketing begins. Further, monitoring staff should be made aware of any problems that arose during the development phase that might have an impact on project compliance and viability;
4. Monitoring staff should give feedback to development and underwriting staff on the performance of projects and identify possible physical and financial issues that might inform project selection or "packaging" of better projects in the future; and
5. Monitoring staff should give feedback to technical assistance staff so that it can tailor technical assistance to the specific needs of the projects, as needed.

7.3. The Annual Monitoring Plan and Procedures

The PJ must monitor every rental project in its portfolio during the period of affordability in order to determine if HOME-assisted properties comply with HOME rent and occupancy requirements. For many PJs, the inventory of HOME-assisted rental units grows each year. Although it is not a HOME requirement, a well thought out monitoring plan can help the PJ manage its growing portfolio and monitoring obligation, and direct limited time to the properties most at-risk.

This section provides guidance on how to develop a monitoring plan to assist the PJ in its efforts to assess the compliance, physical condition, and financial viability of the property. It explains the key components of the monitoring plan: monitoring objectives, identification of properties that will be monitored that year, the staffing plan, and the monitoring procedures for staff to follow.

7.3.A. Monitoring Objectives

At a minimum, during the affordability period, the primary monitoring objectives should be to determine whether:

1. **The property complies with all of the HOME requirements**, including:
 - HOME rent limits;
 - Property standards;
 - Tenant selection, leases, and protections;
 - HOME income limits;
 - Tenant income verification and recertification;
 - Affirmative marketing; and

-
- Unit mix.
 - 2. **The property is maintained in standard condition**, in accordance with applicable property standards (discussed in Chapter 6).
 - 3. **The property is financially stable.** Once a property fails, it is no longer able to provide affordable units to low- and very low-income families, and is therefore noncompliant with the HOME Program requirements. In the event of project failure, the PJ is subject to repayment of HOME funds to the HOME account, and the affordable housing inventory is lost to the community.

7.3.B. Properties to Be Monitored

The annual monitoring plan should identify all properties that the PJ plans to monitor that year and what monitoring activities will be conducted.

- The plan should specify that *all* rental properties are subject to an annual desk review of the required rent and occupancy report. It should specify if the PJ has imposed any additional reporting submissions.
- The plan should specify which properties will be monitored on-site for a records review and a property/unit inspection. The frequency of *required* on-site visits for file reviews and unit inspections are based on the size of the property, as specified in Exhibit 7-2, above. In addition to the properties that must be visited, the PJ should identify any additional properties that it recommends for an on-site visit(s) based on its own assessment of the property's risk. Exhibit 7-4 identifies when a PJ might decide to conduct an additional on-site visit.

A schedule is recommended as a way of planning workload and guiding monitoring staff.

Exhibit 7-4: When to Consider Additional On-Site Visits

Some properties warrant more frequent on-site monitoring than the minimum required by HUD, such as:

- Properties with inexperienced property owners and/or property management staff;
- Properties identified in underwriting as having tight operating budgets;
- Properties that have inadequate operating and/or replacement reserves;
- Properties in certain neighborhoods where marketability of the project may be at risk;
- Properties with multiple funding sources that increase the challenges of compliance;
- Properties where a review of financial statements suggests there may be financial difficulties; and
- Properties that have previously had compliance problems.

7.3.C. Technical Assistance

For enhanced monitoring, the monitoring plan should identify which projects are in need of technical assistance, and should specify what type of technical assistance is planned. One-on-one training for staff of projects that are just coming online, and where the property management staff is new to the HOME Program, is strongly recommended. Additional technical assistance should be based on needs identified in the monitoring process.

7.3.D. Staffing

The annual monitoring plan should identify the staffing needed to accommodate the desk reviews and on-site visits contained in the schedule. The on-site records review should be conducted by program staff familiar with the requirements of the HOME Program. The on-site unit and property inspections should be conducted by

inspection staff that is trained in the codes and standards that apply to the property. These are often not the same staff persons. The plan might identify specific staff assignments to conduct each of the monitoring reviews, or this might be left to be determined by a supervisor.

All monitoring staff should have adequate training and/or experience in the HOME Program and should be familiar with the long-term obligations of owners and PJs. If staff training is needed, the planned training should also be identified in the plan.

7.3.E. Monitoring Procedures

The monitoring plan should outline the monitoring procedures staff follow when it conducts desk reviews and on-site visits. Procedures help staff to be complete, fair, and consistent in their monitoring activities.

The procedures should identify what activities are conducted on-site, including:

- Scheduling and advance contact with the owner and manager;
- Entrance protocols;
- File sampling and review;
- Selection of units for inspection and inspection procedures;
- Other financial and management topics to be reviewed; and
- Exit interviews.

The PJ should also have procedures for issuing the results of its monitoring visits and activities, including procedures for issuing monitoring letters and following up on monitoring findings and/or matters of advice or concern. Key procedures include:

- Composition of monitoring letters;
- Process for approving and issuing letters; and
- Requirements for response.

Refer to the guides listed in Section 7.2.C for additional guidance on monitoring letters and follow-up.

7.4. Monitoring Activities

Generally, HOME monitoring involves three monitoring methods:

- “Desk reviews” of reports and other information that owners submit to PJs;
- Reviews of records retained by the owner/manager on-site; and
- On-site property and unit inspections.

This section describes how these three monitoring methods are used to monitor for HOME compliance and how they can be expanded to facilitate the PJ’s review of the long-term financial feasibility and physical condition of properties. This section distinguishes between required compliance monitoring and recommended enhanced monitoring activities.

7.4.A. Desk Monitoring: Reviewing and Analyzing Reports

A desk review is a review of reports and/or records that the owner submits to the PJ. Desk reviews, as their name suggests, are conducted in the PJ’s office. This provides the PJ a relatively easy means of monitoring activities at its rental properties without the added expense and time involved in scheduling on-site visits.

A report provides only a snapshot of information, but by carefully reviewing submitted reports and monitoring changes and trends, PJs can use reports effectively to identify potential problems or concerns.

Required Reporting

The HOME regulations at 24 CFR 92.252(f)(2) require owners to submit a rent and occupancy report to the PJ on an annual basis. The PJ must review this report to determine if occupancy and rents meet the requirements of the HOME Program and the terms of the written agreement between the owner and the PJ. The PJ must specify the format of the rent and occupancy report and the submission deadline. While the rent and occupancy report is required on an annual basis only, for larger properties or properties with high turnover or other occupancy or management issues, PJs may want to require owners to submit this report more frequently— perhaps quarterly or even monthly.

The recommended elements of the rent and occupancy report are specified in Exhibit 7-5. In addition, a sample Rent and Occupancy report is included as Attachment 2-A, found at the end of this chapter.

Exhibit 7-5: Elements of a Rent and Occupancy Report

In general, the rent and occupancy report should identify:

- Each HOME-assisted unit;
- Whether the unit is a High HOME Rent unit or a Low HOME Rent unit;
- Whether the unit is a fixed unit or a floating unit;
- Tenant's name;
- Tenant household's annual gross income;
- Number of people in the unit;
- Whether any occupant of the unit qualifies as disabled;
- Number of bedrooms in the unit;
- Date of the initial income verification;
- Date of the last income recertification;
- Rent charged;
- Whether the tenant pays for utilities, and the utility allowance; and
- Whether the unit is in compliance with property standards, including lead-based paint abatement and accessibility standards.

What to Look for in the Rent and Occupancy Report

Upon receipt of the rent and occupancy report, the PJ should evaluate:

- Whether there are sufficient HOME-assisted units to meet the required unit mix specified in the written agreement;
- Whether all HOME-assisted units are occupied by income-eligible households, in accordance with HOME income limits in effect at time of certification;
- Whether the owner is charging tenants rents that are in accordance with High HOME Rent and Low HOME Rent limits for the type of unit in effect at the time of lease execution or renewal, including allowances for tenant-paid utilities;
- Whether the owner is calculating rent limits correctly when the tenant pays utilities, or for special projects such as single-room occupancy housing, group homes, projects with project-based assistance, and projects with Low-Income Housing Tax Credits;
- Whether the owner accurately adjusted the rent for any tenant that is now over-income; and

-
- Whether the owner has followed requirements for filling the next available unit when the property has an over-income tenant. Temporary noncompliance when a tenant becomes over-income is permissible, provided that the owner takes steps to bring the property back into compliance when a unit becomes available. The PJ should follow up with the project owner to be sure the owner takes these steps.

Chapters 2, 3, and 4 review the rules related to tenant income-eligibility, rent restrictions, and how to restore compliance when a tenant becomes over-income.

Recommended Reporting for Enhanced Monitoring

At most properties, a number of internal documents, reports, and other data are generated in the course of managing the property, to facilitate the property's management and enable the owner to track the property's financial performance. The PJ can request or require the owner to submit this information to help it evaluate the property's management capacity and financial position. In most instances, this additional reporting should not constitute significant additional work to the owner or manager.

The PJ can get a reasonably accurate picture of a property's financial and managerial standing with the following information:

- Property management plan;
- Property performance goals; and
- Annual financial statements.

Attachment 2-B, *Desk Reviews for Enhanced Monitoring*, summarizes what each of these reports is, what the PJ should look for in its review of each report, and any alternative sources of information, should a property not have a particular report. The PJ may also ask owners to provide narrative progress reports with their submissions, to explain any changes, issues, or concerns that have arisen during the reporting period, such as changing neighborhood economic conditions, increasing crime in the neighborhood, high unit turn-over, marketing difficulties, or code violations on the property.

While introducing new reporting requirements to review overall property performance and long-term viability, PJs should work with owners to solicit the property's existing reports initially. As new projects come on line, PJs can specify its reporting requirements from the outset; this should be included in the PJ's written agreement with the owner.

7.4.B. On-Site Monitoring: Records Review

PJs are required to conduct on-site visits of HOME-assisted properties throughout the property's affordability period. The on-site visit has two components:

1. A review of records and files retained on-site that document the owner's compliance with all HOME requirements, including verification of the data the owner submits on the rent and occupancy report.
2. Physical inspection of the property and inspection of a sample of units in the property.

The PJ may conduct the on-site review of records at the same time as the property and unit inspections, or these on-site visits may be scheduled separately. On-site visits must be done on the minimum scheduled outlined in Exhibit 7-2, based on the total number of units in the property. The PJ should use the results of its desk reviews to determine if a property should be inspected more frequently than the minimum required.

Required On-Site Records Review

The main purpose of the records review is to determine if the property is in compliance with key HOME requirements, which are reviewed in Part I of this guide. It also presents another opportunity for the PJ to gather general information about the viability and management of the property, to provide technical assistance as needed, and to build a working relationship with the owner.

Owners are often reluctant to notify the PJ when problems arise. But most problems are best addressed early. When conducting site visits, PJs should use the opportunity to reinforce the message that the PJ and owner are in partnership to provide affordable housing to the community, to build a relationship with the project owner and manager, and to provide technical assistance and informal training to the property management staff, as needed. In the long-run, a strong partnership between the PJ and the owner is in the PJ's best interest.

Prior to the on-site visit, the PJ should review the results of its most recent desk review(s), and identify any areas that are confusing or potentially problematic for the property. When on site, the PJ staff can pinpoint outstanding issues and follow-up on specific areas of concern.

At the site visit, the PJ must look at all records that document the owner's compliance with HOME requirements. These cover:

- Tenant income-eligibility;
- Rent restrictions;
- Affirmative marketing;
- Tenant selection; and
- Property standards.

The PJ should use the on-site records to verify the accuracy of the reports the owner has submitted. Exhibit 7-6 identifies the documents that the PJ must review to determine whether the property is in compliance with HOME requirements.

Exhibit 7-6: Documents to Review On-Site

HOME Requirement	Documents Required to Demonstrate Compliance
Tenant income-eligibility	<ul style="list-style-type: none"> • Information on household size and other criteria for eligibility; • Income calculations and documentation; • Tenant leases; and • Documentation of eviction, if applicable.
Tenant selection and affirmative marketing	<ul style="list-style-type: none"> • Tenant selection policies; • Waiting lists; • Correspondence related to applications for applicants who have been rejected; • Rent roll; • Affirmative marketing procedures; and • Marketing materials.
HOME rent restrictions (Rent Limits and utility allowances)	<ul style="list-style-type: none"> • Information on HOME rents charged for each unit; • Utility allowances; and • Number, mix, and location of HOME units.
Property standards	<ul style="list-style-type: none"> • Follow-up to PJ inspections, if applicable; • Owner/Manager inspections; • Records related to capital needs and expenditures; • Repair records and maintenance-related correspondence in the file; • Documentation of lead notices, inspections, and repair work, if applicable; and • Capital needs assessments and plans.

Owners must keep individual tenant income, rent, and inspection records for the most recent five years throughout the period of affordability, until five years after the affordability period ends. If there is any litigation, claim, negotiation, audit, monitoring, inspection, or other action started before the expiration of the required retention period, the owner must retain the records until these issues have been resolved. The record-keeping requirements should be specified in the written agreement between the owner and the PJ.

Recommended Records Review for Enhanced Monitoring

Most of the records that the PJ reviews are required for compliance monitoring. However, there are some additional records the PJ may wish to review:

- Records related to the property's finances, if the PJ has not reviewed these records as part of its desk review. These records might include the annual operating budget, the balance sheet, the income statement, the property's expense ledgers, rent rolls, or other day-to-day financial logs;
- Records that relate to any other area of concern for the PJ, such as capital expenditures, security, or insurance; and
- Records on preventive maintenance performed on building systems and logs of managers' unit inspections (to augment the property inspections, discussed in the following section).

In addition to reviewing records, PJs should use the on-site visit(s) to informally assess the property manager's expertise and management skill. Signs of good management include offices and files that are well-organized, property managers that are friendly and know their tenants, and properties and grounds that are well-maintained.

7.4.C. On-Site Monitoring: Property Inspections

Reviews of reports and records can give only an "on paper" perspective of what is happening in a rental property. For a fully informed perspective, the PJ must use this information in conjunction with an on-site evaluation.

Required Property Inspections

The PJ must inspect the property's exterior and common spaces and a reasonable sample of HOME-assisted units to verify that HOME-assisted properties are maintained in accordance with applicable codes and property standards. (See Exhibit 6-1 in Chapter 6 for applicable property standards.) In addition, the PJ must verify that the owner has conducted visual assessments of deteriorating paint and failed lead-based paint hazard controls. Inspections must be conducted by property inspectors that have been trained in the applicable codes.

PJs are never permitted to charge a fee to owners for initial property inspections. However, if a PJ inspects a property and finds any deficiencies, it can charge the owner a fee for any re-inspections necessary to verify that the deficiencies have been corrected. The PJ should specify its right to charge for re-inspections in its written agreement with the owner.

On-site property inspections must occur on the minimum schedule outlined in Exhibit 7-2, above.

Number of Units to Inspect

HUD requires PJs to inspect a "reasonable sample" of units in a site visit. A good rule of thumb is:

- Inspect 15 to 20 percent of the HOME-assisted units in a property for properties with 20 or fewer units;
- Inspect 10 to 15 percent of the HOME-assisted units in a property with more than 20 units; and
- Inspect at least one unit in each building in a multi-building property.

In small properties, these percentages may not yield enough units for the PJ to determine if the owner is complying with property standards. PJs should have a minimum number of units (three to five) to be inspected in any property.

Absent any evidence of problems at the property, this sample size should be sufficient to indicate that the property is in compliance. However, when compliance problems are found in the random sample, the PJ should review all unit files and conduct inspections of all HOME-assisted units.

Recommended Review of Physical Maintenance Activities for Enhanced Monitoring

While PJs are required to inspect a sample of assisted units and common areas as part of determining compliance with HOME property standards, enhanced monitoring suggests that the inspector also review general building and grounds for overall maintenance during the required inspections.

In addition, between required inspections, it is recommended that PJs conduct drive-by inspections on a periodic basis, for a relatively quick assessment of the physical condition of the properties in its portfolio. This information can help the PJ identify properties that may need more frequent inspections or other interventions. The following warning signs can be identified by a drive-by inspection:

- Trash and litter, and other signs of poorly maintained grounds;
- Lack of, or unattended landscaping;
- Outdoor lighting that is not maintained;
- Graffiti;
- Deteriorating structures or structural damage; and
- Other signs of neglect.

7.5. Addressing HOME Compliance Problems

Most HOME compliance problems at a property are uncovered during the PJ's monitoring activities. Once uncovered, the PJ must take steps, or require the owner to take steps, to rectify the noncompliance. The PJ's written agreement with the owner must describe the remedies that the PJ can use to correct compliance issues. See Chapter 1 for a discussion of the elements of the written agreement and enforcement provisions.

The PJ's actions should be consistent with the severity and extent of the noncompliance with HOME requirements. For purposes of discussing approaches to compliance problems, it might be useful to categorize HOME monitoring violations in three levels:

- Level 1: One-time instances of noncompliance;
- Level 2: Moderate to severe instances of noncompliance that have multiple occurrences, and/or suggest that there are problems with management or operational issues in carrying out the requirements; and
- Level 3: Instances of gross negligence, fraud, discrimination, or physical conditions that pose an imminent threat to the health or safety of the tenants.

Exhibit 7-7, below, provides examples of each type of violation and specifies the steps the PJ should take to correct the violations.

Exhibit 7-7: Sample HOME Compliance Problems

	Examples of Violations	Steps the PJ Can Take
Level 1 One-time instance of noncompliance	<ul style="list-style-type: none"> • Single instance of property maintenance issues, such as broken windows; • Single instance of an incorrect rent calculation; • Single instance of failure to raise the rent of an over-income tenant; or • Untimely reports. 	<ul style="list-style-type: none"> • Document the violation(s) in a letter to owner with a schedule to correct the violation(s). Specify consequences if owner fails to correct them. • Follow up and verify that problem is corrected; and/or • Monitor more frequently to ensure that the problem does not recur.
Level 2 Serious and recurring instances of noncompliance	<ul style="list-style-type: none"> • Incorrect, or absence of, income-eligibility determinations for tenant applicants; • Incorrect, or absence of, annual tenant income-eligibility recertifications; • Failure to adopt or follow tenant selection procedures; • Failure to charge correct rents. 	<ul style="list-style-type: none"> • Convene meeting and direct owner to correct the deficiency, within specified timeframe. • Document meeting and directives with follow-up letter; • Follow up to verify violations have been corrected; • <i>Optional steps:</i> Increase monitoring of the property; provide technical assistance, if it appears the staff lacks of knowledge about HOME requirements; impose a one-time or short-term financial penalty, to reinforce the serious nature of the violations.
Level 3 Instances of gross negligence, fraud, discrimination, or conditions that impose imminent threat to tenants' health or safety	<ul style="list-style-type: none"> • Failure to address major systems repairs (such as heating systems); • Chronic misrepresentation of availability of units to qualified applicants in order to show favoritism to relatives; or • Purposefully overcharging rents and skimming the difference. 	<ul style="list-style-type: none"> • Convene with the owner to identify the violation(s) and establish a timeframe to correct it/them. • <i>Optional steps:</i> Execute a written agreement to specify specific terms and conditions to address the violation; and/or impose a permanent or long-term financial penalty on the owner; and/or direct the owner to replace the staff or management entity involved; and/or take legal action. • Follow up closely to determine that violations are corrected. • Increase frequency of reporting by owner; and/or on-site monitoring activity.

When there are noncompliance issues at a property, there are a wide range of financial and non-financial corrective actions a PJ can take. The PJ must reserve the right take these corrective actions in its written agreement with the owner. The PJ's ability to intervene depends entirely on the strength of this written agreement.

Some examples of appropriate corrective actions include:

- Require the owner to make property improvements and pay for re-inspection of units;
- Require the owner to reimburse overpaid rent to tenants;
- Accelerate the repayment of some portion of the HOME loan;
- Accelerate full payment of the balance of the loan (i.e., calling the loan);
- Amend the terms of the HOME loan (e.g., increasing the interest rate);
- Require the owner to submit additional reports or to submit reports on a more frequent basis;
- Increase monitoring visits;
- Restrict the owner's decision-making powers;
- Restart or extend the affordability period;
- Require the owner to secure a new management agent;
- Require a change in property ownership;
- Foreclose the property;
- Restrict the owner from participating in future HOME-funded programs; and/or
- Work to add the owner/manager to HUD's debarred list.

Note, for HOME properties that also have Low-Income Housing Tax Credit (LIHTC) assistance, the PJ should report any violations it uncovers to the state tax credit authority. The PJ does not have the authority to enforce tax credit violations.

Importance of the Written Agreement to Enforcing Compliance

The PJ's ability to respond to problems that it identifies is enhanced or limited by the written agreement it executes with the project owner. The written agreement is the legal tool that holds owners accountable to meet HOME and the PJ's requirements. If the written agreement clearly specifies the PJ's rights to enforce its terms and intervene when necessary, the PJ will be well-positioned to respond to issues that arise to keep its properties in compliance and out of financial trouble.

Attachment 7-B: Desk Reviews for Enhanced Monitoring

PJs should review the following information during the course of their required desk reviews, in order to assess the financial and managerial viability of their HOME-assisted properties.

7.5.A. Property Management Plan

- **What It Is:** The property management plan is developed by a property owner to document the processes and procedures for managing the property in the areas of:
 - Overall management (staffing, financing, reporting, and other administrative tasks);
 - Leasing (tenant selection, determining income-eligibility, establishing and collecting rents, enforcing leases);
 - Marketing; and
 - Property maintenance.
- **What the PJ Should Review:** The PJ should review the property management plan carefully to make sure all HOME requirements are incorporated into the property’s management system and operational procedures: affordability (rent restrictions, income limits, and unit mix requirements), marketing, property maintenance, and tenant rights and protections. The PJ can prevent possible noncompliance by reviewing the property management plan before the property leases up, and providing any necessary feedback to the owner at this time.

Often, the property management plan is developed in the property’s first year of operation, and is updated annually. It can be expected that the PJ’s initial review of this plan will be the most labor-intensive.
- **Alternative Sources of this Type of Information:** In the absence of a property management plan, the PJ may wish to review the property management contract (if the owner is using a third party manager), or copies of the property’s policies and procedures for leasing, marketing, and property maintenance.

7.5.B. Performance Goals

- **What It Is:** Performance goals describe how the owner would like its HOME-assisted property to perform from a managerial and financial perspective. Typically, the owner identifies a standard of measure and a timeline for each performance goal, and directs the property manager to collect the required data to report on those goals on a periodic basis.

Performance goals related to rental property management might include:

 - Stabilized occupancy of the property (based on the pro forma and absorption projections) initially within “x” months, and maintenance of stabilized occupancy level year-to-year;
 - Conduct of annual unit inspections by property manager on lease renewal; or
 - Vacant unit turnaround with “x” days.
- **What the PJ Should Review:** The PJ should (1) Assess whether the performance goals are realistic and achievable, given the area’s housing market; and (2) Evaluate whether the property is meeting its goals.

The PJ could require owners to report on performance goals when the goal is achieved, or at regular periodic intervals (usually quarterly or annually). When a property does not meet its performance goals, the PJ should contact the owner to find out why, and may wish to conduct an on-site visit to learn more.
- **Alternative Sources of this Type of Information:** In the absence of performance goals established by the owner, or in the event the PJ finds the owner’s performance goals inadequate for its purposes, the PJ can

develop its own performance goals or identify select indicators to track property performance. Some common rental property performance indicators include:

- **Number of, and reason for, vacancies.** Examine the number or percentage of units vacant at the end of the month and compare it to the projected occupancy or vacancy levels presented in the property’s operating pro forma.
- **Number of units off-line.** Identify the number of units not available for occupancy due to rehabilitation or significant repair needs. The report should include how long and why each unit has been off-line and the reason it is off-line. Given the PJ’s knowledge of any planned work at the property, the number of units off-line should be reasonable.
- **Unit turnaround time.** Examine the amount of time between the day a unit is vacated by a tenant and when it is occupied by a new tenant. Management should have a goal of preparing and renting turnover units within 10 – 14 days of vacancy. Longer turnaround time might be a reflection of poor management or marketing difficulties.
- **Recent or pending property maintenance activities or capital expenditures.** Determine whether the owner is maintaining the property in decent condition following preventive maintenance plans. Also, review whether the owner is making capital investments in accordance with the capital needs plan.
- **Status of recent compliance findings.** Review previous compliance monitoring results to determine whether or not the owner has resolved all compliance findings.

These performance indicators, in combination with the financial indicators discussed in the following section, provide a fairly good picture of the property’s financial and management standing.

7.5.C. Financial Reports

- **What It Is:** Several key financial statements can help the PJ assess the property’s financial standing:
 - **Operating budget** is a statement of the property’s anticipated revenue and operating expenses for the coming year;
 - **Balance sheet** is a statement that lists all the property’s assets (sources), liabilities (uses), and owner’s equity at the close of its accounting period; and
 - **Income statement**, also known as the profit and loss statement, shows the profitability of the property over a specified period of time.

If available, the PJ should request that the property owner submit financial reports that have been reviewed by an independent auditor.

- **What the PJ Should Review:** Financial reports provide important information to the PJ about the property’s financial position. This review is especially important because the earliest signs of property distress often show up as financial difficulties. Overall, the PJ will want to assess:
 - If the property is profitable and is generating an appropriate rate of return to the owner;
 - If the property’s actual revenue and expenses are consistent with the assumptions made during underwriting, as presented in the property’s operating pro forma. If the operating assumptions have not held true-- and costs are far greater or revenue is far less than what was projected-- the PJ will want to assess and understand potential impact on the property. The PJ should discuss these issues with the owner and be sure that the owner has a plan for making changes to the property’s operations in order to help it stay on track fiscally.

In addition, the PJ should track some specific financial indicators, such as:

- ***The property’s rent roll (gross potential rent) and actual rent collections.*** Compare the total amount of potential rent (that is, if all the units were occupied) with the actual amount of rent collected. Compare the actual collections to budgeted collections (100% minus vacancy/collection loss.)
 - ***Tenant accounts receivable.*** Examine the amount of rent and other fees owed to the property, but not received. Examine how this has grown (or shrunk) over recent reporting periods.
 - ***Accounts payable.*** Examine the total amount of unpaid bills, including a breakdown of any bills that are overdue by 30, 60, or 90 days.
 - ***Beginning and ending cash balance.*** Compare the total amount of cash in bank accounts on the first and last day of the month.
 - ***Balance in operating and replacement reserves.*** Assess whether the owner makes regular deposits into the operating reserve and reserve for replacement, in accordance with its operating budget. Failure to deposit funds into the reserve for replacement may reflect cash flow problems and may lead to problems making capital repairs when needed.
 - ***Management and compliance findings.*** In the property’s annual audit, review the management and compliance letters, to identify compliance or financial management problems or irregularities.
- **Alternative Sources of this Information:** Every property should generate annual financial reports. The PJ should collect this information at least annually, but the PJ may wish to collect interim financial reports more often from properties that are not meeting their performance goals, or from properties that exhibit risk characteristics such as low occupancy, high turnover, management problems, or marketing problems. When the property’s financial performance is not consistent with its goals, or the assumptions of the operating pro forma, the PJ should contact the owner to determine why, and should assess the seriousness of the situation. It should follow up with on-site visits and/or additional reporting requirements to monitor areas of concern until they are resolved.

Chapter 8: Intervening When Things Go Wrong

8.1. Overview

The previous chapters have explained how to prevent property distress through sustainable underwriting; thorough written agreements; comprehensive, enhanced monitoring; and follow-up on HOME compliance problems. Sometimes, however, even with the PJ's best efforts, financial and physical viability problems cannot be avoided. This chapter provides guidance on how to intervene when a HOME-assisted property is in financial and/or physical distress. It provides guidance on interventions that might help stem the distress from when problems first start to emerge. Further, it explains how to structure workouts to preserve the affordable units, for properties that are failing.

8.2. Early Warning Signs of Property Distress

Early warning signs are the “red flags” that indicate that something may be wrong with the financial or physical health of a HOME-assisted property. The first signs of potential problems are usually financial. Financial distress can lead to physical distress because cash is insufficient to perform ongoing maintenance or address capital needs. Once a property fails to be maintained, it becomes hard to retain and attract good tenants, and can result in increasing tenant and possibly staff turnover.

Although these signs may not be HOME compliance problems, the PJ should be concerned about them because they may indicate that the property is at-risk of failure at some point in the foreseeable future. Once a property fails to meet its obligation to provide affordable housing, the PJ is obligated to repay HOME funds to HUD.

At the earliest sign of financial stress at a property, the PJ should contact the owner to try and understand the problem. If the problem is a one-time occurrence, the PJ should be sure to monitor the issue in the future. If the problem is more serious and is not easily remedied, the PJ should meet with the owner to determine if there are any intervention strategies that might rectify the situation.

Exhibit 8-1 describes some common early warning signs. Many of these signs can be identified in desk reviews, as discussed in Chapter 7. PJs might also identify these signs at property inspections.

Exhibit 8-1: Early Warning Signs to Identify Failing Property Performance

Performance Indicator	Performance Standard (typical)	Early Warning Signs
Occupancy and vacancy rates	Properties should have a target occupancy level (usually 93 – 95%), based on market conditions, as indicated on occupancy reports and rent rolls.	Higher vacancy rates result in a loss of income for the property. <i>Possible causes:</i> Management problems, marketing issues, neighborhood decline.
Tenant receivables/ collection loss	Change in tenant receivables year-to-year.	Failure to collect rent is one aspect of vacancy and collection loss. Growing receivables is a sign of distress. Rising tenant receivables may quickly make it difficult for property managers to pay bills on time, and make required reserves deposits. <i>Possible causes:</i> Lax management/rent collection efforts; or tenants' inability to pay due to unemployment/ problems in the local economy.
Breakeven	Breakeven point is the occupancy level at which operating expenses and debt service are covered: (operating expenses + debt service/rent roll).	The breakeven point is the occupancy level at which all expenses are covered. Occupancy below the breakeven point means the property cannot pay all expenses. A rising breakeven point year-to-year means that operating expenses are increasing faster than rents, and may result in an inability to pay all expenses in the future. <i>Possible causes:</i> Lax management/rent collection efforts; failure to increase rents; failure to control operating costs; under-budgeting of expenses; excessive debt.
Operating account balance	Cash balance should be sufficient to cover anticipated monthly operating expenses.	Decreasing or low cash balances mean that a property is having difficulty covering expenses in the near future. <i>Possible causes:</i> Either decreasing income to the property or increasing expenses. The cause(s) should be evident from the property's monthly financial statement.
Accounts payable	Majority of accounts are paid in a timely manner; 30-day or more delinquent accounts are pursued by management promptly. Decreasing Current Ratios (current assets / current liabilities) is one indicator	Increasing or high accounts payable and numerous past due accounts indicates the property is not paying its bills on time. <i>Possible causes:</i> Property manager is not collecting all available sources of revenue, or rents do not adequately cover the property's expenses.
Reserve balances	Operating and replacement reserve balances should be increasing year-to-year.	If either/both operating and replacement reserves are declining, the property is using reserves faster than contributions are being made, and may need to long-term problems. <i>Possible causes:</i> Under-budgeting of expenses or over-estimation of revenues; failure to collect rents.
Capital needs expenditures	Capital needs are addressed in a timely manner, based on a capital needs assessment or useful life analysis and schedule.	Increasing or unexpected capital needs, or capital needs that are out of line with the budget and/or the planned timing of capital improvements. <i>Possible causes:</i> Poor initial planning; routine maintenance is not being performed. Note, the former will impact cash flow; the latter will result in premature systems and equipment failures.

Exhibit 8-1: Early Warning Signs to Identify Failing Property Performance *(continued)*

Property condition	Property should receive routine maintenance, and remain in standard condition.	Deteriorating property condition or increase in code violations. <i>Possible causes:</i> Property does not have enough cash reserves to pay for needed maintenance or repairs, or poor management (i.e., the property manager is not addressing the property’s maintenance needs). Poor physical condition of the property may result in violations of relevant local codes, which in turn violates HOME property standards requirements and may cause health and safety concerns for tenants. Ongoing neglect of the property’s physical maintenance will lead to difficulties marketing the property to tenants.
Unit turnaround	Vacant units should be made available for occupancy and re-rented in three to fourteen days.	Slow unit turnaround results in a loss of income for the property. <i>Possible causes:</i> Management issues (such as poor communication between maintenance and office management) or marketing difficulties (e.g., finding the right tenant).
Local economy and crime		Decline in the local economy that results in higher numbers of unemployed tenants, that impacts rent collection; or increase in neighborhood crime, that impacts the property’s ability to attract good tenants, and also leads to problems collecting sufficient rent to cover expenses. Note, while the decline of the neighborhood can contribute to the decline of the property, so too can the decline of the property contribute to the stress or decline of a neighborhood.
Property management staff turnover		High or frequent staff turnover. <i>Possible causes:</i> Difficulties with managing the property.

8.3. Addressing Performance and Viability Problems

Generally, it is in the PJ’s best interest to intervene to keep its HOME-assisted properties viable and operational, in order to maintain affordable housing stock in the jurisdiction and to avoid repayment of HOME funds. If the PJ identifies project problems early, it is more likely to do so successfully, than if it waits until the problem becomes too complex or deep-seated to address. When it is clear that the property is in danger of failing, however, the PJ must decide whether or not the cost of intervention is worth the investment.

There are no standard interventions that a PJ must take when a project is failing. The appropriate interventions depend on the causes of the property failure, the willingness of other partners to participate in solving the property’s problems, and the local housing market conditions. When a property is facing difficulties, problem-solving must be targeted to the specific project, and must take a comprehensive view of the project’s unique situation.

The interventions discussed in this section are some common actions that a PJ may wish to consider. Not every intervention listed is appropriate or applicable in every situation.

8.3.A. Early Intervention: Technical Assistance and Increased Oversight

If a property is facing emerging signs of possible financial trouble, but it is still well-maintained and tenant retention and marketing is still good, the PJ should work with the owner to identify ways to improve management, increase revenues, and cut costs. The PJ should explore these options:

- **Provide technical assistance to property management staff or require the owner to secure new property management staff to address problems with property management practices.** Many early financial problems can be corrected with improved rental management practices. Property managers must be knowledgeable about HOME requirements and property management functions, and owners should provide training, as needed. Changes should be made if the property manager is failing to:
 - Implement sound financial management: Collecting rents and all other available resources, paying bills on time, and making investments into the reserve account(s);
 - Use effective marketing techniques and change techniques as the housing market changes, develop and maintain a waiting list, reduce vacancy rates, or reduce the turn-around time of vacant units;
 - Conduct routine maintenance and capital improvements, and respond to work order requests from tenants in a timely manner;
- **For nonprofit owners, provide technical assistance on rental management practices related to financial control, staff development, board involvement and fiduciary responsibilities, and fundraising.**
- **Analyze cost data and help the owner identify ways to lower costs.** These actions might involve negotiating new or existing service contracts, or reducing payroll costs. Where appropriate, it may involve making an initial capital investment to install energy efficient appliances or equipment to lower utility costs.
- **Help the owner identify new sources of revenue.** In addition to securing all available sources of revenue, owners may need to identify new sources of revenue. Owners may have access to additional capital through conventional loans, refinancing the property, and owner equity. In some situations, it may be appropriate for property managers to help eligible tenants apply for tenant-based rental assistance from the PJ.
- **Encourage the owner to borrow from reserve accounts to meet short-term expenses, in limited circumstances.** The owner might consider suspending payments to the reserve account or using deposited funds from the replacement reserve accounts to cover short-term expenses. However, this should be done *only* when the owner is able to repay them. If owner is not able to pay back the reserve account, problems will increase when major systems fail and no funds are available to pay for replacement. If the owner taps, or stops paying into the reserve account, the PJ should be sure that the owner has a workout plan that addresses how these funds will be replenished.

8.3.B. Intermediate Interventions: Financial Modifications

If the property is facing significant financial problems, coupled with a deteriorating physical asset, the PJ and owner will need more involved solutions. At this stage in the distress cycle, the property's decline will not be reversed by increasing revenues or decreasing costs alone.

The PJ should involve the owner and other stakeholders to determine how to increase revenues to the property (described above) *and* to address property maintenance, security, and marketing issues. Some additional options to consider include:

- **Review rent structure and approve higher rents, if possible.** If the property is not charging rents up to the maximum High and Low HOME Rents, the owner and PJ should evaluate whether or not increasing rents is a viable option, given the neighborhood market rents and the targeted tenant population. If the owner is able to demonstrate to the PJ that the HOME rents are not sufficient to cover operating costs, and all other options have been exhausted, the PJ may request exception rents from HUD. Exception rents are approved in very

limited circumstances, when HUD determines that all other options have been exhausted. Note, HOME rents and income targeting requirements are statutory and cannot be waived by HUD.

- **Redesignate assisted units as non-assisted and increase rents accordingly.** This option is available only in properties where the PJ designated a higher number of HOME-assisted units than the minimum number required by HUD. By redesignating units, the owner might be able to charge higher rents for non-assisted units, and may be able to fill vacancies more quickly without the need to conduct income determinations. This change will require an amendment to the written agreement, and the PJ is required to notify HUD.
- **Refinance existing private debt at lower interest rate.** The owner may be able to refinance its first mortgage, although new closing costs will be incurred.
- **Invest additional funds in the property.** After the first twelve months following project completion, PJs generally are not permitted to reinvest additional HOME funds in a property during the period of affordability. PJs may request a waiver of this requirement from HUD; however, the owner's ability to invest additional funds in the property should be evaluated as well. Requests to waive HOME regulations are in handled in accordance with 24 CFR 92.4.
- **Use HOME to refinance non-HOME funds in property.** Using HOME funds for refinancing must be coupled with rehabilitation. If the PJ chooses to do this during affordability period, it requires HUD approval. The PJ must follow refinancing guidelines in its Consolidated Plan that meet the requirements 24 CFR 92.306(b)(2).

8.3.C. Advanced Intervention: Workouts

When a property is in serious financial trouble, and the physical asset and property marketability is declining, the PJ may need to take more drastic steps to intervene when all other options have failed.

Approach to a Workout

If a workout is necessary to restore property compliance and viability, then the PJ will need to approach it with the following principles in mind:

- **Get all stakeholders to the table.** This includes the owner, manager (if involved), and all lenders and funders; and may include the syndicator (if the project has LIHTC assistance), municipal/regulatory agencies, potential funders, local housing authority, or community/neighborhood groups that may have a stake.
- **Consult HUD early.** HUD staff should be made aware of the problem and the PJ's and the owner's efforts. HUD expects the PJ to do its "due diligence" before it participates. HUD staff may be able to provide insight and suggestions, but it is unlikely that HUD or the HOME Program will consent to any waivers, additional investments, or other modifications until the PJ, owner, and other stakeholders have developed a comprehensive workout for the property. HUD approvals will be contingent upon the comprehensive solution. See Section 8.4, below, for additional discussion of the HUD role.
- **Approach the project and its problems comprehensively.** Identify all market, financial, physical, managerial, and social issues that exist for the project. Keep in mind that physical needs are most often greater than they appear or are reported to be. Do a comprehensive needs analysis.
- **Workouts must be "over-engineered."** The problems for the project are usually worse than they appear and they will continue to grow as the workout evolves, so the property's needs are likely to be greater than currently represented by the time the workout is consummated.
- **Workouts must enhance viability for the affordability period.** The expected outcome of the workout should be stabilization of the project and its ability to remain viable for at least the affordability period. Workouts that only staunch the bleeding temporarily or do not ensure the viability of the project result in effort that needs to be repeated, and are not valid grounds for additional public investment.

- **Workouts must preserve or enhance affordability.** A workout that sacrifices affordable units or affordability for the remaining tenants cannot be seen as a good solution. Minor adjustments in affordable units might be necessary, but remaining units need to remain affordable and the needs of existing tenants must be met.
- **Share the pain.** Everyone involved in the project (owner, funders, etc.) must contribute to the workout. It is not possible for participants to sit on the sidelines and not absorb some of the impact. Those funders who choose not to contribute more may need to yield or subordinate to other funders.

Negotiating a Workout

During the workout negotiations, remember that every party has different interests, concerns, tolerance for risk, and ability to contribute. It is important that PJs analyze the interests of each party and search for shared interests as the basis for discussion.

PJs should take time to analyze each stakeholder's BATNA – Best Alternative To Negotiated Agreement. In other words, what does each stakeholder confront if a workout does not result from negotiations? Some stakeholders may not have other acceptable outcomes and may be more willing to negotiate than those who have other options to pursue. It is unlikely that stakeholders will contribute more than they have to under other alternatives. Usually, the other stakeholders will eventually agree to contribute to the workout as long as the workout is better than their BATNA.

But, PJs should be prepared for stakeholders to decline to participate in or refuse to contribute to the workout – probably several times before they agree. PJs should be persistent and follow the principles noted above.

Workout Options

When the property is in serious financial crisis, coupled with the decline of the physical property, the PJ might pursue any of the following steps:

- **Change the HOME financing terms.** If HOME funds were invested as amortizing loans, the PJ might modify the HOME mortgage to defer mortgage payments altogether, or reduce monthly mortgage payments by lengthening the term. This is the easiest way to reduce the mortgage payments without incurring new closing costs. The debt is paid off more slowly, however.
- **Defer payments on the HOME loans.** If HOME funds were invested as amortizing loans, the PJ can temporarily suspend or reduce principal and/or interest payments. The PJ should keep the deferral period as short as possible, and increase payments after deferral. This step may be used as a temporary measure until a full-scale workout plan can be put into place.
- **Change terms of the private loan.** The PJ and/or owner should approach private lenders to determine their willingness to reduce the principal and/or interest payments in order to lower monthly mortgage payments. Although this represents a loss to the lender on the loan, the lender may be willing to do this as a way of avoiding foreclosure.
- **Foreclose on the property** (if the PJ is a lender and the owner defaults on loan payments). If there are other lien holders, the PJ will need to negotiate the terms of the foreclosure and any workout plan.
 - Even in the event of foreclosure, the PJ is responsible for ensuring that the property remains HOME compliant or the PJ must repay to HUD the outstanding HOME loan balance or grant amount.
 - The written agreement between the owner and the PJ, described in Chapter 1, should specify the PJ's rights to take action before the property goes into foreclosure or is transferred in lieu of foreclosure.
- **Transfer project ownership.** Transferring ownership is a viable option when the owner/management entity is failing but the project is healthy and better management would solve the problem, and another entity wants the project and has rental management capacity. The PJ can provide incentives to new owners by modifying the HOME loan terms, transforming the loan into a grant, or reducing the set-aside of HOME units. If the property is transferred to a new owner, HUD considers the affordability requirements to be met if the new owner enters

into a written agreement subjecting the property to the remaining HOME affordability requirements. This agreement absolves the PJ of the obligation to repay the HOME funds. However, depending on the written agreement with the original owner, this transfer of the property may or may not absolve the original owner of the obligation to repay the HOME assistance to the PJ. This decision is at the PJ's discretion.

- **Take property into receivership.** The PJ might pursue a court order, depending on state law, to take over the management of the property. Once it is named receiver, the PJ could appoint new management to the property. This option only makes sense when the owner refuses to cooperate and the property manager does not have necessary skills. This option is not appropriate if the property manager has capacity and the owner is cooperative.

Regardless of the interventions taken, if the owner is in default of its agreement with the PJ or if the property is out of compliance with the HOME requirements, the PJ may require the owner to repay all or a portion of the HOME assistance, in accordance with the written agreement. The PJ may also prohibit the owner from obtaining HOME funds for other rental housing developments in the future.

If the PJ's interventions do not work, and the property continues to fail, the PJ must pursue enforcement of its written agreement with the owner, and may need to foreclose. The PJ must repay any outstanding HOME loan or grant to its HOME account if the property fails to meet requirements of the written agreement during the full affordability period.

Workout Agreements

If an intervention or workout results from the PJ's efforts, corrective actions must be identified in a written workout agreement between the PJ and the owner. This workout agreement should be signed by any other parties to the property as well. Exhibit 8-2 describes the contents of a workout agreement.

HUD requires that PJs execute a written agreement with the owner(s) to document each party's responsibilities in any intervention strategy. This might be a new written agreement, a modification to the existing PJ-owner written agreement, or an inter-creditor agreement, if applicable. The written agreement should be enforceable and should specify what additional rights the PJ has to ensure that the owner fulfills its responsibilities.

The workout agreement must ensure the assisted property remains HOME compliant for the full affordability period. The PJ must monitor the property closely and ensure that the intervention strategy is implemented.

Exhibit 8-2: Contents of a Workout Agreement

Any workout agreement between the PJ and the owner should include:

- Analysis of the problem;
- Specific commitments of each party;
- Intervention budget;
- Length of agreement;
- New targets; and
- Reporting (monthly or quarterly) and monitoring schedule.

8.4. HUD Participation in Workouts of Distressed HOME Properties

The PJ should be in touch with the HUD Field Office when it learns that a HOME-assisted property may be in financial danger. HUD expects the PJ to exercise due diligence by working with the owner to identify strategies to help the property, and take steps to correct the problems. However, HUD can provide advice and technical assistance in this process. If the PJ executes a workout agreement with the owner, it must send a copy to HUD.

The PJ may, at some point in the intervention process, find that a waiver of a HOME requirement(s) might help stabilize the project. HUD will consider requests for waivers of HOME rules if the waiver will enable the PJ to preserve housing affordability in a financially troubled project. PJs should contact the HUD Field Office to pursue waivers of HOME requirements.

The PJ should involve HUD for:

- **Waiver of the affordability period requirement [24 CFR 92.252(e)].** If a property's failure is the result of an extreme circumstance or occurs despite diligent, good faith efforts by the PJ to salvage property, HUD may grant a waiver reducing the period of affordability. If it determines that a property has no remaining useful life or can no longer feasibly continue as affordable housing, HUD has the authority to reduce the length of the affordability period, effectively terminating it. By terminating the affordability period, HUD relieves the PJ of the obligation to repay HOME funds when a project fails to remain affordable for the affordability period. An extreme circumstance might include when the property is no longer habitable due to a natural disaster or fire, and the insurance is insufficient to repay the HOME funds; or where the owner and the PJ demonstrate that they have made good faith efforts to salvage a financially or physically troubled property, but their efforts have been unsuccessful. This authority is used sparingly.
- **Waiver of the requirement that additional HOME funds may not be invested in a property during the period of affordability, after the initial twelve months after project completion [24 CFR 92.214(a)(6)].** A PJ can request a HUD waiver of this requirement in order to provide an additional infusion of HOME funds to help save a failing project. These funds might be used to pay for major repairs; refinance hard debt with soft debt; make room for increased reserve deposits; address vacancy issues; or cover high expenses. HUD will consider this waiver when the additional HOME funds are necessary to preserve affordability, and when this step is part of comprehensive intervention to achieve sustainability and preserve affordability in the project. HUD will look to ensure that there is a public benefit for this additional investment, and may impose additional restrictions on the project, such as a longer affordability period, higher percentage of HOME-assisted units, or higher percentage of low-income occupants.
- **Permission to increase the rents charged to above the HUD-published High HOME Rent and Low HOME Rent limits in accordance with 24 CFR 92.252(g).** HUD has the flexibility to approve "exception rents" on a case by case basis, and it will consider such a waiver for projects that are in trouble during the period of affordability where it is necessary to preserve affordability and is part of a comprehensive intervention to achieve sustainability. HUD does not generally favor this intervention because it reduces affordability in the project. HUD will look to determine that increasing HOME rents is appropriate to the project. Increased rents must be supported by a market analysis and the PJ must demonstrate that the increased rents are likely to stabilize the property, without resulting in rents that are not affordable to target households or increased vacancy rates. This intervention is not appropriate in projects with a high vacancy rate, or where rents are already close to market rate for modest housing, or existing residents were not protected against unaffordable rent increases.

More information on intervention strategies is contained in the HUD training manual entitled, *Staying HOME*. Contact the local HUD Field Office for a copy of this manual.

Appendix A: Resources

Resources about the HOME Program

- The U.S. Department of Housing and Urban Development (HUD) web page is www.hud.gov
- HUD's HOME Program web page is: www.hud.gov/homeprogram/. From site, owners and managers will find the following links helpful:
 - Multifamily Rental Housing Library contains case studies, guidance documents, and technical publications: www.hud.gov/offices/cpd/affordablehousing/programs/home/topical/rental
 - HOME Rent Limits are available from 1998 to the present: <http://www.hud.gov/offices/cpd/affordablehousing/programs/home/limits/rent/>
 - HOME Income Limits are available from 1998 to the present: www.hud.gov/offices/cpd/affordablehousing/programs/home/limits/income
 - The HOME Front (online training): <http://www.hud.gov/offices/cpd/affordablehousing/training/web/index.cfm>
 - The Office of Affordable Housing Programs mailing list (sign up to receive an email each time the HOME web page is updated): www.hud.gov/subscribe.

Resources about Property Management

- *Staying HOME* is a training course in HOME asset management practices sponsored by the HUD Office of Community Planning and Development. For more information or to register: www.cpdtraininginstitute.com/stayingdescription.cfm
- HUD's model program guide, *Asset Management: Strategies for the Successful Operation of Affordable Rental Housing* (HUD-2018-CPD, May 2000) provides guidance on managing HOME-assisted properties. This guide can be ordered at no cost from Community Connections, at 1-800-998-9999 or www.comcon.org.
- The Consortium for Housing and Asset Management (CHAM) is a partnership between the Enterprise Foundation, the Local Initiatives Support Corporation (LISC), and the Neighborhood Reinvestment Corporation. CHAM is devoted to promoting asset and property management best practices and training. Its web page is www.cham.org. This site includes best practices, sample forms, recommended resources, training opportunities, and links to other related information.
- The Enterprise Foundation operates local neighborhood development programs, best practices research, and funding to affordable housing developers. Its web page is www.enterprisefoundation.org.
- The Institute of Real Estate Management (IREM) provides educational resources and best practices information for real estate management professionals. Membership in one of its 81 U.S. chapters may be

required to access sample forms, research publications, and other resources. For more information, call (800) 837-0706 or www.irem.org.

- NeighborWorks Multifamily Initiative promotes best practices in property management. Its homepage is www.nw.org. This site provides property management forms and links to training opportunities.
- A Guide to Comprehensive Asset and Property Management: A Manual for Building Communities through Good Asset and Property Management. Published 10/01/1997 by the Local Initiatives Support Corporation (LISC), this 250-page guide describes an approach to the oversight and management of residential properties aimed at supporting the growth and development of residents. It is available for purchase by emailing odi@lisc.org. Other publications and materials can be accessed directly at www.lisc.org.
- The following organizations also provide trainings in asset management:
 - Institute of Real Estate Management (IREM), www.irem.org;
 - National Association of Housing and Redevelopment Officials (NAHRO), www.nahro.org;
 - Neighborhood Reinvestment Training Institute, www.nw.org;
 - National Center for Housing Management, www.nchm.org; and
 - Local Initiatives Support Corporation (LISC), www.lisc.org.



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