



# Federal Register

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**Friday,  
November 26, 2004**

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## **Part II**

### **Department of Agriculture**

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**Rural Housing Service  
Rural Business—Cooperative Service  
Rural Utilities Service  
Farm Service Agency**

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**7 CFR Parts 1806 et al.  
Reinvention of the Sections 514, 515,  
516, and 521 Multi-Family Housing  
Programs; Interim Rule**

**DEPARTMENT OF AGRICULTURE****Rural Housing Service****Rural Business—Cooperative Service****Rural Utilities Service****Farm Service Agency**

7 CFR Parts 1806, 1822, 1902, 1925, 1930, 1940, 1942, 1944, 1951, 1955, 1956, 1965, 3560, and 3565

RIN 0575-AC13

**Reinvention of the Sections 514, 515, 516, and 521 Multi-Family Housing Programs**

**AGENCIES:** Rural Housing Service, Rural Business—Cooperative Service, Rural Utilities Service, and Farm Service Agency, USDA.

**ACTION:** Interim final rule; request for comments.

**SUMMARY:** The Rural Housing Service (RHS), formerly Rural Housing and Community Development Service (RHCDS), a successor Agency to the Farmers Home Administration (FmHA), is streamlining and reengineering its regulations, as well as utilizing several private sector processes and techniques in the administration of the origination, management, servicing, and preservation of its Multi-Family Housing (MFH) programs. These programs include the section 515 Rural Rental Housing (RRH) loan program, the section 514/516 Farm Labor Housing loan and grant program, and the section 521 Rental Assistance (RA) program. This interim final rule combines the provisions of the Streamlining and Consolidation of the sections 514, 515, 516, and 521 Multi-Family Housing (MFH) Programs Proposed Rule published on June 2, 2003, and the Operating Assistance for Off-Farm Migrant Farmworker Projects Proposed Rule published on November 2, 2000.

**EFFECTIVE DATE:** February 24, 2005. Written or e-mail comments on this interim final rule must be received on or before December 27, 2004.

**ADDRESSES:** You may submit comments to this rule by any of the following methods:

- Agency Web site: <http://rdinit.usda.gov/regs/>. Follow the instructions for submitting comments on the Web Site.
- E-Mail: [comments@usda.gov](mailto:comments@usda.gov). Include the RIN number (0575-AC13) in the subject line of the message.
- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

- Mail: Submit written comments via Federal Express Mail or another mail courier service requiring a street address to the Branch Chief, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, 300 7th Street, SW., 7th Floor, Suite 701, Washington, DC 20024.

All written comments will be available for public inspection during regular work hours at the 300 7th Street, SW., address listed above.

**FOR FURTHER INFORMATION CONTACT:** Sue Harris-Green, Deputy Director, Multi-Family Housing Direct Loan Division, Rural Housing Service, U.S. Department of Agriculture, Room 1241, South Building, Stop 0781, 1400 Independence Avenue, SW., Washington, DC 20250-0781, telephone (202) 720-1660.

**SUPPLEMENTARY INFORMATION:****Classification**

The interim final rule has been determined to be significant, but not economically significant, and was reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

**Authority**

The existing statutory authority for the MFH programs was established in title V of the Housing Act of 1949, which gave authority to the RHS (then the Farmers Home Administration) to make housing loans to farmers. As a result of this Act, the Agency established single-family and multi-family housing programs. Over time, the sections of the Housing Act of 1949 addressing MFH have been amended a number of times. Amendments have involved issues such as the provision of interest credit, broadening definitions of eligible areas and populations to be served, participation of limited-profit entities, establishment of a rental assistance program, and imposition of a number of restrictive-use provisions and prepayment restrictions.

**Environmental Impact Statement**

This document has been reviewed in accordance with 7 CFR part 1940, subpart G, "Environmental Program." RHS has determined that this action does not constitute a major Federal action significantly affecting the quality of the environment. In accordance with the National Environmental Policy Act of 1969, Pub. L. 91-190, an Environmental Impact Statement is not required.

**Regulatory Flexibility Act**

This interim final rule has been reviewed with regard to the

requirements of the Regulatory Flexibility Act (5 U.S.C. 601-612). The undersigned has determined and certified by signature on this document that this rule will not have a significant economic impact on a substantial number of small entities since this rulemaking action does not involve a new or expanded program nor does it require any more action on the part of a small business than required of a large entity.

**Federalism (Executive Order 13132)**

The policies contained in this rule do not have any substantial direct effect on States, on the relationship between the National Government and the States, or on the distribution of power and responsibilities among the various levels of Government. This rule does not impose substantial direct compliance costs on State and local Governments; therefore, consultation with the States is not required.

**Civil Justice Reform (Executive Order 12988)**

This rule has been reviewed under Executive Order 12988. In accordance with this rule: (1) Unless otherwise specifically provided, all State and local laws that are in conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule except as specifically prescribed in the rule; and (3) administrative proceedings of the National Appeals Division of the Department of Agriculture (7 CFR part 11) must be exhausted before bringing suit in court that challenges action taken under this rule.

**Unfunded Mandate Reform Act (UMRA)**

Title II of the UMRA, Pub. L. 104-4, establishes requirements for Federal Agencies to assess the effects of their regulatory actions on State, local, and tribal Governments and on the private sector. Under section 202 of the UMRA, Federal Agencies generally must prepare a written statement, including cost-benefit analysis, for proposed and Final Rules with "Federal mandates" that may result in expenditures to State, local, or tribal Governments, in the aggregate, or to the private sector, of \$100 million or more in any 1 year. When such a statement is needed for a rule, section 205 of the UMRA generally requires a Federal Agency to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective, or least burdensome alternative that achieves the objectives of the rule.

This rule contains no Federal mandates (under the regulatory

provisions of title II of the UMRA) for State, local, and tribal Governments or for the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

#### **Paperwork Reduction Act of 1995**

The information collection requirements contained in this regulation have been approved by the OMB under the provisions of 44 U.S.C. chapter 35 and have been assigned OMB control number 0575-0189, in accordance with the Paperwork Reduction Act (PRA) of 1995.

Collectively, 2,191,777 hours of paperwork burden will be made obsolete from 12 dockets. The new 3560 regulation imposes 907,389 hours of paperwork burden on the public. This is a decrease of 1,284,388 hours. However, only 111,552 hours of that are due to program changes.

#### **Programs Affected**

The programs affected by this regulation are listed in the Catalog of Federal Domestic Assistance under number 10.405—Farm Labor Housing Loans and Grants; 10.415—Rural Rental Housing Loans; and 10.427—Rural Rental Assistance Payments.

#### **Intergovernmental Consultation**

These loans are subject to the provisions of Executive Order 12372 that require intergovernmental consultation with State and local officials. RHS conducts intergovernmental consultations for each loan in a manner delineated in RD Instruction 1940-J (available in any Rural Development office and on the Internet at <http://www.rdinit.usda.gov/regs/>).

#### **Background Information**

##### *An Overview*

Most communities in the rural United States have a scarcity of decent rental housing that is affordable to very low-income families. In addition, migrant farmworkers and farm laborers, whose incomes are extremely limited, face some of the worst housing conditions in the nation. Despite improvements in housing quality, especially in the number of rural units with complete plumbing facilities, there are about 2.7 million families who live in substandard housing. In the Agency's experience, rural renters were more than twice as likely to live in substandard housing as people who owned their own homes. With lower median incomes and higher poverty rates than homeowners, many renters are simply unable to find decent housing that is affordable. RHS's rental housing programs are some of the

few resources that enable the very low-income renters in the rural United States to access decent, safe, sanitary, and affordable housing. In many rural communities, there are simply no other safe and sanitary alternatives for very low-income people.

Through public and private partnerships, RHS enables limited profit and nonprofit developers to build rental housing for low-income and very low-income tenants across the rural United States. As of February 2004, the nearly \$12 billion portfolio of 463,632 units and more than 17,100 projects often provides the only decent, affordable rental housing available in rural areas. The program provides affordable rental housing to very low- and low-income rural families, to disabled people, and to elderly residents. The average tenant has an adjusted income of \$9,452.

The Agency operates a multifamily rural rental housing direct loan program under section 515 and section 514 for farm labor housing. The Agency also provides grants under the section 516 farm labor housing program. The direct loan program employs a public-private partnership by providing subsidized loans at an interest rate of 1 percent to developers to construct or renovate affordable rental complexes in rural areas. This 1 percent loan keeps the debt service on the property sufficiently low to support below-market rents affordable to low-income tenants. Many of these projects also utilize low-income housing tax credit (LIHTC) proceeds. This program is typically used in conjunction with the RHS section 521 Rental Assistance (RA) program, which provides project-based rental assistance payments to property owners to subsidize tenants' rents to an affordable level. With rental assistance, tenants pay 30 percent of income toward their rent (including utilities). Some section 515 projects also utilize the U.S. Department of Housing and Urban Development's (HUD's) section 8 project-based assistance, which enables additional very low-income families to be served.

The direct loan and grant programs under sections 514 and 516 provide low interest loans and grants to provide housing for farmworkers. These workers may work either at the borrower's farm ("on-farm") or at the borrower's or any other farm ("off-farm") so long as the tenants meet program eligibility requirements. Section 521 rental assistance is available for off-farm labor housing, but not on-farm labor housing. The Agency has decided to not provide RA to on-farm labor housing units because of its limited availability.

#### *Goals of the Regulatory Streamlining Process*

This rule results from RHS's pledge to make its programs more customer friendly, streamline the processes, reduce costs to the taxpayer, and increase the Agency's level of customer service. These goals were accomplished through the input and commitment that resulted from numerous stakeholder meetings with recognized leaders in the multi-family industry, including borrowers, management agents identified by industry groups, and tenant representatives. Representatives of State housing finance agencies, accounting firms, and the USDA Office of Inspector General (OIG) also participated. Through these meetings, RHS was able to draw on a vast amount of expertise and knowledge to meet the following objectives of multi-family housing reinvention:

- Assure affordable safe, decent, and sanitary housing for very low- and low-income residents in rural communities.
- Consolidate and simplify 14 regulations into one regulation for rural rental housing, farm labor housing, and rental assistance.
- Develop an efficient loan application process that supports the creation of partnerships and leveraging with local, State, and other Federal entities.
- Clarify RHS's existing policies and procedures to reflect the best practices within the Agency and within the multi-family field.
- Improve efficiency and service to RHS's customers, correcting past problems and addressing concerns raised by stakeholders so that particularly complex processes, such as preservation, work better.
- Make much of the farm labor housing review and approval processes the same as those for rural rental housing processes.
- Create a series of handbooks available to field staff and to applicants, borrowers, and partners that will give clear guidance on policies, such as developing project budget approvals, determining project feasibility, and servicing actions.

#### *Streamlining and Consolidation*

RHS is undertaking a major redevelopment and consolidation of Rural Development (RD) regulations affecting the sections 514, 515, 516, and 521 Multi-Family Housing programs. Current customers of these programs are affected by 14 separate regulations, but as a result of reinvention, the interim final rule revises and consolidates Agency regulations affecting the

sections 514, 515, 516, and 521 Multi-Family Housing programs. This rule consolidates the policies outlined in 14 separate regulations and a number of Administrative Notices into one regulation and moves the procedural guidance to program handbooks. A list of the regulations being consolidated follows:

- 7 CFR part 1806, subpart A—Real Property Insurance
- 7 CFR part 1930, subpart C—Management and Supervision of Multi-Family Housing Borrowers and Grant Recipients
- 7 CFR part 1944, subpart D—Farm Labor Housing Loan and Grant Policies, Procedures, and Authorizations
- 7 CFR part 1944, subpart E—Rural Rental and Rural Cooperative Housing Loan Policies, Procedures, and Authorizations
- 7 CFR part 1944, subpart L—Tenant Grievance and Appeals Procedure
- 7 CFR part 1951, subpart D—Final Payment on Loans
- 7 CFR part 1951, subpart K—Predetermined Amortization Schedule System (PASS) Account Servicing
- 7 CFR part 1951, subpart N—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Multi-Family Housing
- 7 CFR part 1955, subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property
- 7 CFR part 1955, subpart B—Management of Property
- 7 CFR part 1955, subpart C—Disposal of Inventory Property
- 7 CFR part 1956, subpart B—Debt Settlement Farm Loan Programs and Multi-Family Housing
- 7 CFR part 1965, subpart B—Security Servicing for Multiple Housing Loans
- 7 CFR part 1965, subpart E—Prepayment and Displacement Prevention of Multi-Family Housing Loans

These changes have two clear benefits. First, the consolidated, streamlined regulation makes information easier to access. Answers to policy questions are found in one document that has been shortened from over 1,500 pages to less than 200 pages.

Similarly, answers to process and implementation questions are found in three handbooks. These handbooks provide “how-to” guidance on loan origination, asset management, and loan servicing. Agency staff, property owners, property managers, and residents can look for most answers to day-to-day questions in the handbooks’ plain English explanations and examples. If the regulatory basis for a

procedure is in question, that information can be easily found in the streamlined regulation. The increased ease of finding information will help improve public understanding of the rules and eliminate inconsistencies in interpretation.

Second, the division of policy and procedure gives the Agency more flexibility to update and revise program procedures. For example, as automation changes the way program reporting occurs, relevant procedures can be updated in the handbooks without going through the complex process of changing the regulation. This will make the Agency more responsive to changes in the business environment, an important initiative as the Federal Government strives to have more of its business conducted online and through electronic submissions.

The paperwork burden reduction to the public resulting from this rule will be approximately 45 percent. This estimate is derived from the Paperwork Burden docket that RHS prepared.

#### *The Handbooks*

As stated above, the Agency is finalizing three separate handbooks that present the reader with administrative guidance on loan origination, asset management, and project servicing. The Loan Origination Handbook instructs the reader on application and processing procedures and provides information on matters such as what forms must be filed, where to submit loan requests, and the Agency’s internal processing procedures. It also provides Agency staff with the guidance needed to originate loans and grants efficiently and effectively. The Asset Management Handbook provides RHS Multi-Family Housing staff with guidance about the Agency’s procedures for overseeing borrowers’ performance in meeting their responsibilities under the program. The Project Servicing Handbook provides loan servicers with guidance about the Agency’s procedures for servicing actions involving borrowers that receive loans or grants for MFH projects.

The handbooks are not published in the **Federal Register** but are available to the public at no cost. The public can access the handbooks through their local RHS servicing office.

#### *Exhibits*

Many of the exhibits that were part of the expired regulations may be found in the three companion handbooks to 7 CFR part 3560: Loan Origination, Asset Management, and Project Servicing. As an example, exhibit B–1 of 7 CFR part 1930, subpart C, is found in exhibit 3–

1 of chapter 3 of the Asset Management Handbook.

#### *Discussion of the Interim Final Rule*

This interim final rule combines the provisions of the Streamlining and Consolidation of the sections 514, 515, 516, and 521 Multi-Family Housing (MFH) Programs Proposed Rule published on June 2, 2003, and the Operating Assistance for Off-Farm Migrant Farmworker Projects Proposed Rule published on November 2, 2000.

RHS is issuing this regulation as an interim final rule, with an effective date 30 days after publication in the **Federal Register**, given that these regulatory changes are very extensive, affect all aspects of the programs, and seek to achieve significant streamlining of the programs’ regulatory provisions. Delaying implementation of the rule to allow more time for further consideration would not be in the best interest of the direct MFH program or its recipients. All provisions of this regulation are adopted on an interim final basis, are subject to a 90-day comment period, and will remain in effect until the Agency adopts a final rule.

#### **Changes Presented in the 7 CFR Part 3560 Proposed Rule That Remain Proposed, but Not Implemented in the Interim Final Rule**

##### *Reserve Requirements for Project Improvements*

Current regulations include standards for physical condition, maintenance, and reserve levels to address the physical condition of the property. These regulations require that borrowers initially contribute 1 percent annually of total development costs toward a reserve for project improvements until a total of 10 percent is reached. While borrowers are permitted to request adjustments to their reserve contributions, there is no systematic provision for reevaluating reserves over the life of the project.

The proposed rule included language requiring a life-cycle cost analysis be used to establish the initial reserve amount needed to meet the capital needs of new projects. For existing projects, the proposed rule would have required that any servicing action that involves additional Agency funds must take into account physical needs of the project, based on a capital needs assessment. The regulatory impact analysis for the proposed rule indicated that these provisions would increase rents and result in additional demand for rental assistance payments.

Since the proposed rule was published, RHS has undertaken a comprehensive property assessment of the properties in the section 515 portfolio. The preliminary results provided useful information for reconsidering the extent of capital reserves that may be necessary to meet the capital needs of projects and to explore policy options for addressing these needs to be reflected in any necessary budgetary and legislative changes. More time is needed to properly address these matters. Accordingly, RHS has decided to publish an interim final rule that does not include these provisions—specifically § 3560.103(c)(3) and § 3560.306(k)(1) of the proposed rule—until their impacts can be assessed and policy decisions can be made for a long-term strategy.

For the interim final rule, the Agency is continuing the policy from the existing regulation 7 CFR part 1930, subpart C. Because 7 CFR part 1930, subpart C is being replaced by 7 CFR part 3560 in this rulemaking, the relevant language from the previous regulation is being carried forward and included in § 3560.306(j)(1) (Changes to Reserve Requirements), while the language from § 3560.103(c)(3) is removed and the paragraph marked as reserved.

### **Changes to the Rule With Significant Impact**

#### *Investment Earnings on Reserve Account Funds*

RHS has found that most project owners are putting their reserve funds in accounts that earn no or minimal income. The average reserve account has been earning only 2 percent interest annually. Project owners indicate that, under current regulations and tax rules, they have few options for investing these funds and face a strong disincentive for investing them in a manner that maximizes their return. The disincentive is due to Internal Revenue Service (IRS) rules that treat income earned on reserve accounts as investment income for the owner and thus is taxable, rather than project, income.

This rule makes two changes to address these limitations. First, it allows a greater number of investment options, including relatively conservative investment vehicles that are used by public agencies and are not expected to pose a significant increased risk to the funds. This change would give owners more flexibility for investing their reserve account funds and is expected to result in greater returns on these funds

and thus more income to be put toward better project operations and capital improvements. The increase in interest income would lower the amount needed from tenant rents and rental assistance to meet project needs.

Second, the rule addresses the issue of “phantom income”—the interest income earned on reserve accounts. This income is committed to the project but not accessible to the owner. To ease the burden of paying taxes on this phantom income by for profit and limited profit entities, the rule allows owners, with RHS’s approval, to withdraw up to 25 percent of the annual interest income earned on the reserve funds to cover the tax expense. The 25 percent allowance was determined to be a reasonable estimate of the tax rate for the average investor. It was decided to use a single rate for all owners to simplify the administration of this feature. RHS also consulted with the USDA OIG and the American Institute of Certified Public Accountants (AICPA) to arrive at the 25 percent figure.

#### *Transferring Surplus Funds*

Prior regulations required that if a property had a surplus in its general operating account at the end of the project’s fiscal year in excess of 10 percent, the amount over 10 percent had to be transferred into the property’s reserve for replacement account. This policy has been changed so that if a project has surplus cash in excess of 20 percent at the end of the project’s fiscal year, the amount over 20 percent must be transferred to the reserve account. Numerous comments to the proposed rule said that the prior policy allows for no contingency should the project have an unplanned, extraordinary expense. The policy also results in project cash flows that are extremely tight. The new policy in the interim final rule should help to mitigate these cash flow problems.

#### *Treatment of Surplus Operating Funds Transferred to the Reserve Account*

As stated above, the Agency requires surplus funds in a project’s operating account to be transferred into the project’s reserve account. However, there was confusion about whether the amount transferred could be deducted from the scheduled contributions to the reserve account. This issue is clarified in the interim final rule, which states that transfers of surplus funds into the reserve account may not be deducted from the scheduled contribution. The surplus funds are to be used for addressing a project’s capital needs.

#### *Prepayment Policies and Procedures*

The Agency, borrowers, and tenant advocates agreed that the prepayment request process is difficult and confusing. Agency staff in the National Office recognized that they were spending a great deal of time providing technical assistance to Field Offices in responding to prepayment requests. Borrowers commented that the process was unduly burdensome to borrowers who were within their rights to request prepayment. Tenant advocates pointed out that tenants are virtually excluded from the process because the process complexity makes it difficult for tenants to take action. Discussion of these concerns at the stakeholder meetings indicated that RHS needed to clarify many of the policies toward prepayment and, where possible, make policy changes that would help simplify the process. Consequently, this rule includes changes to Agency policy regarding tenant notification and projects on the waiting list for incentives.

#### *Tenant Notifications*

Stakeholders suggested changes to the content and timing of tenant notifications to provide tenants with the information they need to participate in the prepayment process. This rule replaces the requirement for one early tenant notification with a series of notifications aimed at keeping the tenants informed of the Agency’s and the borrower’s decisions throughout the process.

#### *Alternatives to Acceleration When Needed To Preserve Affordable Units*

The Agency received numerous comments on the proposed rule on the preservation process. One issue that was raised repeatedly is that the Agency should have alternative means to sanction a borrower for monetary or nonmonetary default without accelerating the borrower’s account. Commenters expressed concern that a borrower could force the Agency to accelerate the loan to be able to prepay the loan. The Agency cannot prevent such an occurrence in all cases, but has added language to the interim final rule to acknowledge this problem and to demonstrate its intention to prevent it from occurring. Before accelerating a project loan, the Agency will consider the possibility that the borrower is forcing an acceleration to circumvent the prepayment process. If it is found that this is the borrower’s motivation, the Agency will consider alternatives to acceleration, such as suing for specific performance under loan and

management documents. Subpart J of the interim final rule provides several alternatives to acceleration.

#### *Waiting List*

One of the most common complaints heard about the prepayment process is its open-ended nature. Borrowers who are approved for incentives and agree to stay in the program in exchange for incentives may have to wait years before the funds for the incentives become available. The interim final rule establishes a maximum time on the waiting list of 15 months and allows borrowers three choices at the end of that time: (1) Stay on the waiting list and continue waiting for the incentives; (2) withdraw from the list and continue operating the property for program purposes; or (3) offer to sell the property to a nonprofit organization. This last option may allow some properties to eventually prepay if they complete the process involved in offering the project for sale and fail to receive a bona fide offer. This option responds to the reality that the Agency may not always have the resources to keep borrowers in the program indefinitely and that costly legal battles are likely if it does not allow other options to the borrowers. Further, it is believed that many borrowers have not applied for prepayment incentives and joined the waiting list because of the extended time period they must currently remain on the list. If the 15-month maximum time period is implemented, a greater number of these borrowers may seek prepayment with the expectation that they will be allowed to exercise one of the three options at the end of the 15-month time period. If borrowers do prepay and convert their apartment complexes to market rate units, RHS will take measures to protect the tenants at these properties by providing them with a letter of priority entitlement (LOPE) that gives them priority in Agency-financed housing elsewhere. However, if alternative vacant RHS-financed rental housing is not available in the market, the impacted tenants face displacement or rent overburden if they remain in place.

#### *Incentives*

The interim final rule clarifies the Agency's policy on incentives and adds several requirements to help ensure that the limited amount of funding available for incentives, as discussed in the overview section of this analysis, is used efficiently to benefit the program. For example, this rule outlines the process a borrower must follow when requesting permission to prepay and be eligible to receive incentives.

In addition, the proposed rule clarifies that third-party equity loans are an option for borrowers who are seeking equity loans through the prepayment process. The use of third-party equity funding stretches RHS's incentive funds by providing resources from alternative funding sources. However, it should be noted that debt costs from other sources might be higher than financing received under the section 515 program. For example, section 515 funding is lent at an effective 1 percent interest rate and amortized for 50 years, whereas third-party funds may be lent at rates ranging from interest free to market rate depending upon the source of the funds, with amortization periods ranging from fully deferred to 30 years. All proposed third-party equity loans must be underwritten and reviewed to the same standard as section 515 loans to ensure that no project is made financially unfeasible as a result of a third-party loan.

#### *Initial Operating Capital*

Under previous regulations, borrowers were required to pay the equivalent of 2 percent of the cost of developing a project into an account for initial operating costs. They earned no interest on this account, which also received funds from other sources, including rental income. If within 2 years the project was operating successfully and there was sufficient capital in the operating account to maintain the financial soundness of the account, borrowers might take out up to the full amount of their contribution. While on deposit in the operating account, borrowers received no return on investment for the funds. After 2 years, any portion of the contribution that remained in the account must remain in the account to meet ongoing operating capital needs. During the stakeholder meetings, borrowers expressed concern that the previous regulation did not allow them sufficient time to recover their contribution, even when a project is functioning well and no longer needs the additional capital. RHS determined that the 2-year limit was originally set due to difficulties in tracking the funds within the project's overall budget, and that its new management information system, has the capability to provide better tracking and disclosure of these funds. Therefore, RHS is extending the time limit for the recovery of initial operating capital from 2 to 7 years. In selecting 7 years for the new limit, RHS received input from field staff and industry groups indicating that the prospects for recovery after 7 years were minimal, either because financial soundness

could not be established or owners were willing to leave their contribution in the account.

This change allows more borrowers to fully recover the payments they make to initial operating capital accounts. It is uncertain how many borrowers would benefit from the change and how many dollars these borrowers would be allowed to recover from these accounts. Because of the limitation on recovery from only financially sound accounts, it is unlikely that there would be immediate, negative impacts on the performance of the MFH programs. However, it should be noted that by allowing borrowers to recover funds from initial operating capital accounts, these funds would not be available for ongoing capital needs. The potential withdrawal of initial operating capital is not considered to have significant impacts on rents and thus on costs to the Government and tenants.

#### **Other Changes to the Rule**

##### *Conventional Rents for Comparable Units*

RHS has incorporated the concept of "conventional rents for comparable units" (CRCU), which is one of the most important policies established by the interim final rule. The concept is applicable to loan origination, loan servicing, replacement reserve set asides, and preservation. In essence, rents are to be capped at conventional rents for comparable units in the area where the housing is located. Comparable units would be those equivalent to RHS-financed units in terms of quality and amenities. If no such units are located in the same community, units from a similar community could be used for comparison. Comparable units also means that the units the Agency finances would meet a standard of economical development—modest in size, facilities, and design, yet compatible with the community.

RHS will continue to require that rents be based on the project's operating costs. However, the interim final rule requires that RHS not approve project proposals, servicing actions, or prepayment incentives that involve rents above the CRCU, except in limited circumstances, where such rents are determined to be in the best interest of the Government and the tenants of the project. The Agency wants to emphasize that the comparison to CRCUs is not used during annual budget reviews and requests for rent changes.

By placing an upper limit on rents, RHS expects to protect the Government from investing in projects that may be

wasteful or fraudulent, and to ensure that projects are competitive so that vacancy and other market-driven problems can be avoided. In this way, the CRCU should improve the long-term viability of MFH projects, limit the costs of rental assistance, and reduce the risk of defaults.

The interim final rule maintains flexibility for serving areas where MFH projects provide the only decent, safe, and sanitary affordable rental housing in a local housing market, or where a significant amount of the substandard housing rents for less than the cost of operating a MFH project. In such cases, RHS may base the CRCU on rents outside the local community. It may also grant an exemption for exceptional circumstances.

The CRCU will create a definitive underwriting standard. It will apply to leveraging other low-interest loan funds or paying for additional owner contributions (up to 3 percent return on investment over required contribution), improving project design and amenities (within the definition of economical development), and adjusting reserves or other serving actions. In areas where rents are below the CRCU, rental assistance costs and loan levels may increase. However, it will also ensure "marketable units" if the Agency should lose rental assistance units.

#### *Cost Reasonableness Basis for the Evaluation of Project Proposals*

The interim final rule also includes changes related to evaluating the cost reasonableness of project proposals. Under current regulations, the Agency has applied a policy of cost containment when evaluating whether the costs of the proposed design for new projects are reasonable. While this policy has effectively held down construction costs for new projects, Agency field staff and borrowers report that lower-cost project design features are not always cost effective over the long term. They report that while certain design features reduce initial construction costs, they actually cost more over the life of the project because the components used require higher levels of maintenance and more frequent replacement.

Projects with these design features experience higher routine maintenance costs, higher expenditures of project reserves, and a greater need for subsequent financing for rehabilitation. The result is an upward pressure on project rents and increased use of rental assistance funding. To the extent a project cannot support the rent increases needed to cover these costs, the project faces an increased risk of

financial failure or compliance violations due to physical deficiencies.

Previously, RHS had no process for conducting life-cycle analyses. The requirement for a life-cycle cost analysis is to be used for new projects. The requirement is intended to assure quality construction, as well as the long-term viability of complexes. Under the interim final rule, the Agency will change its policy for evaluating project proposals to consider the life-cycle costs of proposed project designs. Under this policy, the Agency may approve a proposed project design that is not the lowest cost if the life-cycle cost analysis that is prepared by the project architect reveals that the design achieves the lowest overall cost over the life of the project. Industry standards will be used for the analysis. To assure that new projects are affordable and appropriate to the local housing market, this rule restricts the Agency from approving project designs that would cause rents to exceed the market standard (except in exceptional circumstances where such costs are determined to be in the best interest of the Government and the tenants). Examples of two design features that may cost more initially but decrease operating expenses over the life of the project are brick exteriors and increased thermal standards. In the past, many projects were built using a popular exterior plywood siding. These buildings require replacement of the original siding. Similar buildings that utilized brick as an exterior finish or partial finish are not having similar expenses, thereby decreasing demands on the reserve accounts. Thermal standards in RHS-financed projects often exceed local codes. By building RHS projects with more energy efficiency, tenant and owner utility expenses are kept lower, thereby decreasing the need for rent increases or tenant utility allowance increases. By avoiding the additional rent and utility allowance increases, tenant rent overburden is avoided, as is the additional drain on scarce rental assistance resources.

Because this change will allow for more costly designs, the Agency expects the size of initial loans and initial rents to grow slightly. However, higher upfront costs would be offset by lower long-term costs. The Agency expects that new projects receiving funding under this policy will have lower maintenance and rehabilitation needs, thereby lowering project rents and use of Agency rental assistance over the life of the project. Lower maintenance expenses, resulting in rents essentially the same as projects built under cost containment guidelines, would offset

the increased debt service due to higher construction costs. This change will also lower demand for subsequent loans from the Agency in a time when additional loan funds are increasingly scarce.

#### *Management Certification*

Under previous regulations, RHS needed to approve the management agreement between the borrower and the management entity for a project. This requirement for Agency approval was designed to ensure that the management agent was also accountable for meeting program requirements. However, the Agency has found that this policy resulted in a time-consuming approval process because these agreements varied considerably from borrower to borrower, and lacked the consistency necessary to implement a national program. Further, the USDA OIG has found that many management agreements and plans lack the specificity to accurately describe how project and management costs are prorated between expenses paid by the project fee and those paid by the management fee.

The interim final rule eliminates Agency approval of management agreements and instead requires borrowers to submit a management certification in an Agency-approved format. In submitting this document, borrowers certify that their agreement with the project management entity obligates that entity to comply with program requirements; establishes sanctions for failure to comply with these requirements, including termination of the agent; and specifies penalties for false certifications. This change eliminates the administrative burden on RHS for approving management agreements, while strengthening the Agency's ability to hold borrowers and their agents accountable for their management responsibilities. In addition, revisions to the management fee policy, discussed below, allow for a more definitive method to differentiate between project and management agent expenses.

#### *Management Plan*

Under previous regulations, borrowers were also required to obtain RHS's approval of the management plans for their projects. The purpose of this policy was to assure the Agency that the borrower and management entities would have adequate systems in place to comply with program requirements. The requirement to obtain Agency approval for updates only added to the burden for both the Agency staff and the borrowers. This policy also left

the Agency in an awkward position when borrowers with sound projects changed their operations but did not update their management plan. The USDA OIG has reported audit findings where borrowers and management agents have not been operating the properties in conformity with the executed management plan. While this is true, RHS has found that the agent and owner have not engaged in an improper practice; instead, the practice is just not documented correctly in the management plan. The OIG has agreed that if the practice had been correctly disclosed in the management plan, the practice would not have been listed as an audit finding. The OIG has worked with RHS during the stakeholder process to identify changes in policy and procedures and has addressed this particular area of confusion. The result of the change will establish clearer borrower and management agent accountability combined with procedures that discourage RHS micromanagement of borrower and management agent business practices. Additionally, fewer OIG findings will result, requiring less OIG and RHS staff time to resolve.

The interim final rule eliminates Agency approval of project management plans and instead requires that borrowers submit a management plan that addresses a specified list of operational areas. RHS staff will review the plan to see if the required areas have been covered in the plan but will not approve the plan. The plan will be used to monitor project performance, but discrepancies between project operations and the plan will not constitute a violation of program requirements, unless the discrepancies affect program performance. This change reduces the administrative burden on RHS staff and borrowers. It also provides borrowers with greater flexibility to make sound changes in project operations without creating a performance concern.

#### *Management Fees*

Previously, program regulations required that management fees for projects be reasonable and competitive. However, the USDA OIG staff found that the management fees approved for projects varied significantly, ranging from as low as \$25 per unit per month to \$55 per unit per month across States. This led the OIG to question whether the higher fees found in some instances were reasonable. As with management plans, the OIG expressed concern that the current regulations were neither clear nor consistent concerning what services were to be included in the

management fee. In some States many of the maintenance services provided by management company staff were included in the management fees, and in other States the charges were not. In some States insurance and tax costs for project employees were included in management fees, while in other States the costs were billed directly to the project. Comments by Agency staff at stakeholder meetings revealed that the variations were often due to differences in Field Office interpretations about the services to be covered by the management fee. They noted that services not covered by the fee were paid for as a line item on the budget. When management fees plus other fees for services were accounted for, management compensation was consistent. Together with representatives of the property management industry and the OIG, RHS developed the bundle of management services that is a part of this regulatory change. By moving to a standardized grouping of services that is to be included in the management fee, RHS and the OIG believe that the change will greatly improve consistency among different areas of the country and RHS offices. As stated in the previous paragraph, as these services were all being provided previously but charged to the project on different lines of the operating budget. The grouping of these expenses in a different manner would neither increase nor decrease the overall cost to the project or the rents being charged.

The interim final rule and accompanying handbooks address the inconsistencies in fees by establishing a standard bundle of services covered by the management fee and a framework for setting standard adjustments for project characteristics that warrant slightly higher fees, such as for a new management agent taking over a troubled property. However, this rule should improve RHS's ability to document that the management fees for projects are reasonable. It should also ensure consistency among RHS Field Offices in interpreting the services included in fees. Additionally, the number of OIG findings should be reduced, requiring less OIG and RHS staff time to resolve.

#### *Standards for Physical Conditions at Projects*

Previous regulations established borrowers' responsibility to maintain their projects in decent, safe, and sanitary condition. However, the USDA OIG raised concerns about a lack of consistency in how this standard has been implemented.

The interim final rule establishes specific standards for physical conditions that clarify the conditions that constitute decent, safe, and sanitary housing. These standards do not represent a change in Agency policy. Rather, they make Agency expectations explicit and thus improve the Agency's ability to enforce physical standards, thereby improving the quality of living conditions for tenants and better preserving the security of Agency loans.

#### *Recertifications of Tenant Eligibility*

Recertifications are used to document tenants' income for the purpose of determining eligibility to live in a multi-family housing unit and qualify for rental assistance payments. Previous regulations required both an annual recertification and an interim recertification whenever tenants' income changes. Stakeholders indicated that the recertification process was time consuming for tenants, borrowers, and the Agency.

The interim final rule simplifies the process by eliminating the requirements for an interim recertification for tenants' monthly income changes of less than \$100. RHS arrived at the \$100 threshold by comparing the cost of recertifying tenants with the benefit either the Government or the tenants would receive as a result of increased or decreased rent. Based on consultation with industry groups and the OIG, RHS determined that the cost to recertify a tenant was about \$150. Assuming that any change would apply for only 6 months of the year, the \$150 figure was converted to a monthly figure of \$25, which became the threshold. However, after receiving numerous comments that this threshold amount was too low, that the amount of increase in tenants' contribution toward rent would be minimal, and in consideration of the tenant income profile of RHS properties, the Agency decided to increase the threshold to \$100 per month of income change rather than tenant contribution. The regulation also allows tenants to request an interim recertification any time between annual recertifications if their income changes by \$50 or more per month. This provision was included to avoid adverse impacts on tenants with the lowest income for whom the \$50 per month figure may constitute a significant share of their income.

While a detailed analysis of how the impact of the \$100 and \$50 thresholds might be distributed between the Government and tenants was not completed, recent OIG audits have indicated that the current recertification process produces approximately the same amount of rent increases as rent

decreases, thus resulting in little or no overall change in rental assistance payments.

#### *Lease Protection*

The interim final rule would require that leases for rental units that receive rental assistance include a clause that specifies that tenants' contribution to rent will not increase if rental assistance is terminated due to actions by the borrower/owner. RHS estimates that there have been two to four incidents per year in which borrowers/owners have attempted to make up for the loss of rental assistance payments due to a default on their part by raising tenants' rents. Such action usually occurs in a contentious situation, with the borrowers/owners already in default and uncooperative. Consequently, requiring leases to include a clause specifically prohibiting such action may not resolve all cases. However, it would provide tenants with a regulatory and lease citation that could be used in bringing court proceedings against abusive borrowers/owners. Further, it would provide RHS with an additional instance of noncompliance with regulations that could be used against owners in a liquidation action or in a criminal or civil court case. However, it is uncertain whether cases could be resolved more quickly at less cost to the Government.

While the interim final rule offers some additional protection to tenants and imposes some additional responsibility on borrower/owners, it is difficult to place a monetary value on these impacts. Each case is likely to be different, and the resolutions are uncertain. The low incidence, however, suggests that the impacts would not be significant in value.

#### *Limited English Proficiency (LEP)*

The Agency has issued guidance to clarify the responsibilities of recipients and subrecipients of Federal funds from the Agency to assist them in fulfilling their responsibilities to LEP persons under title VI of the Civil Rights Act, as amended, and implementing regulations. The Agency has incorporated language in subparts A and D of the interim final rule stating that borrowers and grantees must take steps to ensure the meaningful participation in Agency programs and activities by LEP persons free of charge.

#### *Application Process for Rental Subsidies*

Rental subsidies provide critical funds for housing very low-income tenants. Projects that receive RHS's rental assistance, including interest

subsidy and rental assistance payments, depend on the continued availability of these subsidies to maintain in-place tenants in their units. Under previous regulations, borrowers were required to complete full rental assistance requests to renew expiring subsidies. Stakeholders noted that the Agency gathers sufficient information through the budget approval process to assess project needs for rental assistance.

The interim final rule states that expiring subsidies will be renewed at the existing number of units and to the extent that sufficient funds are available. To indicate that rental assistance units are needed, borrowers must fill in a single check box on the project budget form (which must be filed annually) instead of completing a separate form as currently required. These changes relieve borrowers of the burden of applying, and the Agency of the burden of reviewing the requests. Instead, the review can be accomplished as part of the budget approval process. The change has no effect on project or program budgets. It does not change the Agency's determination about rental subsidies; it simply streamlines the process.

#### *Transferring Rental Assistance*

The Agency has revised the interim final rule to state that the Agency will transfer rental assistance from one property to another after it has been unused for 6 months. Prior to transferring the RA, the Agency must conduct an analysis to determine whether any of the current tenants or applicants at the top of the waiting list need RA, so that the subsidy is not transferred prematurely. This provision should help to ensure that rental assistance stays in or is transferred to properties where it is needed the most.

#### *Budget Approval*

RHS requires its borrowers to submit an annual budget, which is used in setting rents. Approximately 92 percent of these budgets arrive for approval at the same time because most owners operate on a calendar-year basis and their schedules for developing budgets is about the same. Budget approval is a time-consuming process that taxes RHS staff resources in times of high volume and forces borrowers to operate for extended periods of time with unapproved budgets while the review process is underway. Previous regulations required that all budgets be reviewed in the same way, regardless of whether they represented no real change from the previous year or contained significant and potentially controversial changes.

The interim final rule establishes an expedited review for those budgets that are within a certain threshold requiring little or no increase in rents. The threshold is based on data to be obtained from the MFIS III ADP system on area-wide norms for projects within RHS's MFH portfolio, as well as commercially available multifamily income and expense surveys. Details on how the threshold will be computed will be contained in the program handbooks rather than in the interim final rule, which will facilitate making any necessary adjustments in the threshold to meet changing conditions.

The new process could improve program performance by allowing RHS to focus its review on those budgets that contain significant changes, while expediting approval of those budgets with little or no change. However, it is unlikely that the new process would have measurable budget impacts, such as reduced rental assistance costs or fewer defaults, because the decisions RHS makes on whether to approve a budget will most likely be the same under the new process as under the existing system. Those decisions will, however, be reached in a more efficient manner.

#### *Summary of Tenant Comments*

There was a requirement in the proposed rule stating that when a borrower requests a rent increase for a particular Agency-financed MFH project, the borrower must provide a summary of all written comments from the tenants to the Agency. The Agency determined that this was a cumbersome and unnecessary requirement as most tenants provide their comments on rent increase proposals directly to the Agency anyway. The Agency removed this requirement, resulting in a decrease in the borrower's burden.

#### *Project Operating Accounts*

The interim final rule states that rather than maintaining separate bank accounts for every property, a borrower or manager of Agency-financed MFH projects may have one operating account for all properties in their portfolio, as long as the borrower, manager, and bank track each property's funds separately. With today's enhanced reporting technology, banks can divide accounts into subaccounts, to ensure accurate reporting of all transactions for each property. In addition, this policy is economical, because it helps the borrower and/or manager save on bank fees and charges for separate accounts.

### *Priorities for Budgeted Expenses*

The priorities for budgeting a property's operating expenses have been revised in the interim final rule. In the proposed rule, the first priority for budgeted expenditures was critical maintenance and operating expenses. Due to comments received by the Agency, the interim final rule now lists amounts owed to a prior lienholder as the first priority for budgeted expenditures. This new policy reflects the current reality that the Agency is not always the primary lienholder on Agency-financed projects. The policy also acknowledges the Agency's focus on participating with other funding sources.

### *Annual Financial Reporting*

Under previous regulations, the Agency required that for all projects of 25 units or more the owners contracted with a Certified Public Accountant (CPA) to perform an audit in accordance with Government Auditing Standards (GAS). Because a large percentage of the Agency's portfolio consists of projects with between 16 and 24 units, annual financial statements have not been prepared for a substantial number of projects financed by the Agency. Moreover, certain components of GAS-audited financial statements did not address the Agency's need for certain information related to specific aspects of project performance, and these financial statements are prohibitively expensive for a substantial portion of the Agency's portfolio. Finally, the previous audit guide did not require the auditor to provide information that remains of specific importance to the Agency, such as information on identity-of-interest (IOI) transactions.

Under the interim final rule, owners of MFH projects with 16 or more units must base their annual financial reports on an engagement report completed according to "agreed upon procedures" established by the Agency, which will be included in detail in the new Multi-Family Housing Engagement Guidelines to be delivered by the Agency. Borrowers must include the engagement report with their annual financial reports submitted to the Agency. These borrowers will not be required to submit a GAS audit prepared by an independent CPA. The new Multi-Family Housing Engagement Guidelines will provide specific instructions on how the individual preparing the annual financial statements should handle compliance issues. The annual financial statements must be completed using agreed upon procedures that help meet certain performance standards.

The engagement must be initiated by borrowers using an engagement letter, which will either:

- Reference the Multi-Family Housing Engagement Guidelines, which will specify the program compliance issues that the Agency wants the preparer to address and the guidelines for testing compliance; or
- State the list of compliance issues that the Agency wants the preparer to address.

Owners of small projects, which are defined as projects with fewer than 16 units, must submit annual financial statements that are prepared in a manner consistent with the Agency's Engagement Guide using a limited scope engagement based on Agency-approved procedures and must certify that the housing meets the performance standards established in the interim final rule. The annual financial statements may be prepared by a CPA or other individual with the training and experience to prepare the report. The information presented in the annual financial statements must be prepared in a manner consistent with the requirements of the Engagement Guide.

In response to USDA OIG concerns, the Agency is implementing these changes to the annual financial reporting system to ensure that a higher percentage of projects submit annual financial statements to the Agency, and that the preparers of these statements are made aware of the Agency's specific concerns so that project funds are spent appropriately.

### *Loans From Third Parties*

In its continuing efforts to streamline and facilitate transfers, the Agency has included a new provision in the interim final rule that specifically allows for loans from a third-party source in conjunction with an ownership transfer or sale of a housing project. The loan may be in the form of a first mortgage or deed of trust, junior or parity lien, or soft second mortgage. This provision should make it easier for purchasers to put together more than one source of financing and allow for greater leveraging of Agency funds.

### *Transfers at New Rates and Terms*

Previously, Agency regulations implied that project transfers typically occur at the same rates and terms as the original loan. In acknowledging the need to streamline and facilitate the transfer process, the Agency will allow transfers to occur at new rates and terms if the transfer would result in lower rents to the tenants than at the original rates and terms. Again, this will help preserve the Agency's affordable

housing resources without increasing the drain on the Agency's budget, and without resulting in higher rents.

### *Equity Loan at the Time of Transfer*

Previously, the regulation prohibited debt to be added to pay for equity to the seller. In an effort to facilitate transfers and provide incentives to sellers to assure the project remains as affordable rental housing, the new regulations will allow for equity loans from the Agency or from third parties at the time of transfer.

### *Special Servicing, Enforcement, Liquidation, and Other Actions*

In response to stakeholder, USDA OIG, and Agency staff comments, the Agency made a number of changes to strengthen Agency servicing. None of the changes to the regulations on servicing constitute changes in policy; rather, they address a lack of clarity in existing rules and incorporate policies that previously existed only in Administrative Notices. As such, the changes are not anticipated to have either a negative or a positive budget impact.

For example, the interim final rule clarifies the definition of "default" by spelling out specific actions that owners may take or fail to take that would cause the Agency to determine that the loan is at risk. The rule also simplifies the submission requirements for transfers of project ownership. Other changes serve to simplify servicing actions in an effort to enhance the Agency's flexibility in addressing servicing issues. These changes allow for swifter and more consistent action to address troubled projects—for example, focusing action for the Agency and borrowers. This would help to avert more serious problems in the long term and allow Agency staff to concentrate their efforts on other portfolio management issues.

### *Additional Enforcement Tools*

As a result of the Debt Collection Improvement Act and other statutes, the Agency has added some important enforcement provisions to the interim final rule. These include provisions allowing the Agency to have the U.S. Attorney bring an action in U.S. court to recover project assets or income, seek civil monetary penalties and other sanctions against borrowers for "equity skimming," and seek legal remedies for money laundering and obstruction of Federal audits. These are important provisions that shift some of the burden of recovering lost resources from the Agency to the rest of the Federal Government and also give the Agency

more effective tools in enforcing its requirements.

#### *Management and Disposition of Real Estate Owned Properties*

The interim final rule consolidates current regulations regarding real estate owned (REO) property and clarifies the specific requirements that apply to MFH properties. Previous regulations addressed many different types of REO properties acquired by USDA, including MFH properties. Often, the guidance provided was generic or related to non-MFH properties. The interim final rule provides specific guidance to MFH properties, taking into consideration the physical condition of the property, occupancy status of the property by eligible program tenants, and determinations of whether the property is still needed under the program. This rule also adds flexibility to the Agency's requirements for selling the property; the change allows the sale to be conducted while taking into account local market conditions. It also provides Field Offices with several options in selling REO properties, giving them authority that previously rested with the National Office. With more options and flexibility, processing and sales times will be reduced.

#### *Farm Labor Housing*

The interim final rule consolidates separate program regulations for the Farm Labor Housing loan and grant program along with separate regulations for other MFH programs. It does, however, maintain separate subparts for off-farm labor housing and on-farm labor housing. This was necessary to preserve the distinction between off-farm labor housing, which consists of multi-unit housing operated by nonprofit corporations or public bodies that receive either loans or grants under the sections 514 and 516 programs, and on-farm labor housing, which consists of single or small multi-family housing operated by farmers who receive only loans. Several statutory changes to the Farm Labor Housing loan and grant program have been made over the past 5 years. Previous regulations have been modified to incorporate these changes prior to drafting this proposed rule. Since the changes are currently in place, they are not addressed again in this analysis. No further program changes other than regulation consolidation are included.

#### *Technical Assistance Grants to Developers of Off-Farm Labor Housing*

The Agency received numerous comments on the proposed rule with regard to technical assistance grants to

developers of off-farm labor housing. The Farm Labor Housing Technical Assistance Final Rule published on October 31, 2002, in the **Federal Register** (67 FR 66308), gives the Agency the authority to award technical assistance grants to eligible private and public nonprofit agencies. These grant recipients will, in turn, assist other organizations to obtain loans and grants for the construction of off-farm labor housing. This information was inadvertently not incorporated into the proposed rule. However, the requirements for technical assistance grants have been incorporated into the interim final rule.

#### *Operating Assistance for Off-Farm Labor Housing*

The Agency published a proposed rule entitled "Operating Assistance for Off-Farm Migrant Farmworker Projects" on November 2, 2000, in the **Federal Register** (65 FR 65790). The requirements for operating assistance were not included in the 7 CFR part 3560 proposed rule, but have been added to the interim final rule. Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under section 514 or section 516 that serve migrant farmworkers. Owners of eligible projects may choose tenant-specific rental assistance as described in § 3560.573 or operating assistance, or a combination of both; however, any tenant or unit assisted under this section may not receive rental assistance under § 3560.572. The objective of this program is to provide assistance toward the cost of operating the project so that rents may be set at rates that are affordable to very low- and low-income migrant farmworkers.

#### *Priorities for Admitting Applicants to Off-Farm Labor Housing*

The previous regulations contained an elaborate and complicated priority system for admitting applicants into off-farm labor housing projects. The Agency received numerous comments on the proposed rule stating that the priority system was cumbersome and confusing. The previous regulations had four priorities, two of which had two subpriorities. These priorities have been streamlined into three simple categories in the interim final rule. This change will result in waiting lists that are simpler to create and maintain and should promote greater adherence to the Agency's admission criteria.

#### *Income Limits for Off-Farm Labor Housing*

Off-farm labor housing applicants and tenants must demonstrate that they earn a certain portion of their annual household income from farm labor. The prior regulation, 7 CFR part 1944, subpart D, exhibit J, provided income thresholds for applicants of off-farm labor housing projects. Borrowers applied these percentages to the income threshold for their particular region of the country. The income thresholds established *de facto* income floors for farm labor housing projects. Exhibit J, however, had not been updated since 1986 and reflected average income figures for farmworkers from 1983. Therefore, the Agency conducted research on average farmworker earnings based on the 2000 U.S. Census and will include an updated version of exhibit J in the Asset Management Handbook. The interim final rule has been revised to state: "Actual dollars earned from farm labor by domestic farm laborers other than migrant farmworkers must equal at least 65 percent of the annual income limits indicated for the standard Federal regions as published by the Agency for their particular region of the country. For migrant farmworkers living in seasonal housing, the actual dollars earned from farm labor by a domestic farm laborer must equal at least 50 percent of annual income limits indicated for the standard Federal regions, as published by the Agency." While imposing these new income limits may result in an increased number of applicants to be ineligible for occupancy in off-farm labor housing, the Agency anticipates that this increase will be extremely small, given the concomitant increase in average farmworker wages during the past 20 years.

#### *Office of Rental Housing Preservation*

Changes to the Housing Act of 1949 required the establishment of an Office of Rental Housing Preservation within RHS for handling matters related the preservation of affordable rental housing in the Agency's MFH portfolio. RHS established this office within its Multi-Family Housing Portfolio Management Division.

The Office of Rental Housing Preservation has already taken steps to enhance the Agency's consistency in reviewing prepayment requests and offering incentives by making a single entity responsible for coordinating all preservation actions. The interim final rule recognizes the establishment of this office and defines its responsibility to

coordinate, direct, and monitor the RHS's MFH preservation activities. This addition to the rule complies with the statute and clarifies the role of the National Office in the preservation process.

#### *Unauthorized Assistance*

When tenants receive unauthorized assistance through their own error, the Agency has a duty to try to recapture the assistance. Under previous regulations, much of this responsibility was put on project owners. The process was both time consuming and burdensome. Furthermore, project owners, as well as RHS, have only limited ability to collect unauthorized assistance, and in many cases the cost of pursuing unauthorized assistance outweighed the funds collected.

Recognizing these circumstances, the interim final rule relieves project owners of the responsibility of recovering unauthorized assistance due to tenant error once tenants have moved. It also provides for RHS to determine whether unauthorized assistance should be pursued. These changes give the Agency greater flexibility to apply resources cost effectively toward cases that most deserve to be pursued, and to relieve project owners of the burden of pursuing tenants who no longer live in their projects. This rule also brings RHS into compliance with the Debt Collection Improvement Act by allowing the use of collection agencies and offsets to collect unauthorized assistance from project owners and tenants.

#### *Market Value, Subject to Restricted Rents*

In the past, the process for determining the security value of Agency-financed MFH projects has been overly complicated and a source of confusion because of the various methods of valuation that the Agency used, some of which were not those typically used and understood by the appraisal industry. Therefore, the interim final rule now clarifies that appraisals must include the "market value" of the property, or the "market value, subject to restricted rents." The term "market value" is defined in § 3560.752. "Market value, subject to restricted rents" means that the appraisal will take into consideration any rent limits, rent subsidies, expense abatements, or restrictive-use conditions that will affect the property as a result of an agreement with the Agency or any other funding source. "Market value, subject to restricted rents" refers only to the value of the subject real property, as

restricted, and excludes the value of any favorable financing. When this value type is part of an appraisal assignment, all favorable financing in place at the time of the appraisal must also be valued, but separately from the real property. The specification and definition of value types will help to ensure that applicants, borrowers, and the Agency receive appraisals that are more accurate and complete.

#### *Conformance With the Appraisal Industry*

Subpart P of the interim final rule has been revised substantially so that the Agency's requirements for multi-family housing appraisals conform to appraisal industry standards. In addition to the specification and definition of value types described above, subpart P establishes new guidelines for appraisal scope, procurement, review, and release. These new requirements should facilitate the appraisal process, as certified general appraisers will be familiar with the terminology and procedures of the revised subpart.

#### *Changes in Definitions*

##### *Disability*

Agency regulations currently have separate definitions for the terms "individual with disability" and "individual with handicap." The definition of the term "individual with disability" is, in large part, taken from section 501(b) of the Housing Act of 1949. The definition of the term "individual with handicap" is taken from the Fair Housing Act. Other civil rights laws, such as the Americans with Disabilities Act (ADA) and section 504 of the Rehabilitation Act of 1973, use the term "disability" rather than "handicap"; however, they define it in the same manner as the Fair Housing Act defines handicap.

Rather than having two separate terms, the Agency will only use the term "disability" and it will be considered equivalent to the term "handicap." If people meet either the Housing Act of 1949's definition of handicap or the Fair Housing Act's definition of handicap, they will be considered disabled.

##### *Nonprofit Organization*

The Agency has streamlined its definition of "nonprofit" and has made it less prescriptive so that more nonprofit organizations are eligible for participation in the Agency's multi-family direct loan programs. Most notably, the aspects of the definition that describe local and regional nonprofit organizations have been broadened. This will result in increased

participation by a wider pool of nonprofit organizations in the construction, transfer, and preservation of Agency-financed multi-family projects. There are additional requirements for what constitutes a nonprofit organization for purposes of farm labor housing and preservation, and these are described in subparts A, L, M, and N.

#### *Additional Definitions*

As a result of comments received on the proposed rule from the public, the Agency has added several definitions to the interim final rule. The addition of these definitions should help to clarify the Agency's policies on a variety of issues. The new definitions and their significance are as follows:

- *Applicant*: Clarifies the distinction between the applicant and the borrower.
- *Appraisal*: Provides the industry definition that the Agency uses.
- *Capital needs assessment*: Explains how the Agency uses this term.
- *Disabled domestic farm laborer*: Explains this category of tenant, so that the farm labor housing priorities for admission are more easily understood.
- *Farm*: Clarifies what the Agency considers an eligible farm, which is particularly helpful in the discussion of farm labor housing.
- *Manufactured housing*: Clarifies what constitutes this type of housing for purposes of interpreting the regulation and handbooks.
- *Market rent*: Provides the industry definition of the term that the Agency uses.
- *Off-farm labor housing*: Distinguishes this type of farm labor housing from on-farm labor housing.
- *On-farm labor housing*: Distinguishes this type of farm labor housing from off-farm labor housing.

#### *Participation With Other Funding or Financing Sources*

The provisions of 7 CFR 3560.66 were revised to encourage participation from public and private sources. The Agency made a number of changes in the proposed rule to provide greater flexibility in the program to allow program financing to be more readily combined with other sources. However, the existing section 515 policy of restricting rental assistance to basic rents that do not exceed what they would have been had the Agency provided full financing is retained. The Agency recognizes that because it is delivering financing at 1 percent, this provision will be difficult for an applicant to meet under the most aggressive leveraging or other low-interest loan funds financing package.

However, the Agency is also responsible for ensuring the efficient, prudent use of rental assistance funding. Without this standard, RHS would face even greater growth in the demand for rental assistance funding over and above the already significant funding levels. For this reason, RHS made the decision to continue this policy.

#### *30-Year Term and 50-Year Amortization Period*

Though not a new issue or policy, this rule requires that new loans have a 30-year term with a 50-year amortization schedule. This rule will clarify that, at the end of 30 years, borrowers have the option to pay off the residual balloon with no restrictive-use on the property, and the Agency has the option to refinance (or not) for the facility's remaining economic life. In effect, loans will have a 30-year use restriction, versus the previous 50-year use restriction, with additional use restrictions only should the Agency refinance.

#### *Conforming Household Income Calculation to Industry Standards*

By changing the calculation of tenant household income and assets to be consistent with other funding sources in the MFH industry, RHS has made a significant contribution to reducing paperwork burden to the public. No longer will a separate calculation have to be made for a MFH loan when a separate calculation was already executed for LIHTCs or another affordable housing program. Tenants' income and assets will be calculated in accordance with 24 CFR 813.106 and 102, which are regulations published by HUD.

#### **Discussion of Comments—Streamlining and Consolidation of the Sections 514, 515, 516, and 521 Multi-Family Housing (MFH) Programs—Proposed Rule**

This proposed rule was published in the **Federal Register** on June 2, 2003 (68 FR 32872), with a 60-day comment period that ended August 1, 2003. Comments were received from 146 commenters yielding nearly 3,000 individual comments about the language in the proposed rule. Commenters included Rural Development personnel, housing advocacy groups, developers, builders, property managers, attorneys, housing organizations, and others with an interest in these housing programs.

Many of the comments focused on areas currently published in the CFR, which were not a part of the proposed rule. As discussed, part of the intent

behind the reengineering and reinvention of these regulations was to remove much of the administrative guidance from the CFR and incorporate this guidance into the program handbooks, which would not be published in the CFR. As discussed above, the handbooks provide the Agency with flexibility in the Agency's administration of program procedures in response to changing circumstances without entering into a rule-making process.

The responses to many comments have indicated that the guidance requested by a commenter is administrative and contained in the applicable handbooks. RHS sincerely appreciates the time and effort of all commenters. Comments, by subpart, from the proposed rule are discussed below.

#### **Subpart A—General Provisions and Definitions**

*Topic:* Regarding civil rights (e.g., limited English proficiency, fair housing compliance, reasonable accommodations, domestic violence), several commenters stated that the Agency did not fully address the requirements of section 504 of the Rehabilitation Act of 1973.

*Response:* The Agency appreciates these comments and has specific references to section 504 requirements in § 3560.2 and § 3560.11 of the interim final rule.

*Topic:* Other commenters were concerned with the sufficiency of the Agency's proposed language with respect to the civil rights responsibilities of borrowers and the protections the language in the proposed rule would offer the applicants to and residents of RHS housing.

*Response:* The Agency has ensured that the civil rights requirements of borrowers are clearly described in the interim rule and internal Agency procedures.

*Topic:* Several commenters addressed the protected classes included in the proposed rule. One commenter believed that age and marital status classes are added under the proposed language and disagreed with this amendment to the regulation. Another commenter believed that sexual orientation should be added. Yet another commenter thought that age and disability are important to take into account.

*Response:* The Agency appreciates these comments and has removed marital status from § 3560.2 because it is not a status specifically protected by civil rights statutes. Age was retained because it is protected by statute.

However, the Agency wants to clarify that when age is established by statute as a program eligibility factor, then it needs to be considered when determining eligibility for occupancy, but only for that determination. Sexual orientation is not a status specifically protected by civil rights statutes, and therefore was not added.

*Topic:* Several commenters identified an occurrence of "accommodation" in the civil rights section, which is not preceded by "reasonable." The commenters urged the Agency to revise this error.

*Response:* The Agency thanks the commenters and has revised the interim final rule at § 3560.2(a)(1).

*Topic:* One commenter suggested that a single point of contact at USDA be established to receive complaints.

*Response:* The Agency acknowledges the comment and has revised § 3560.2(c) in response to this suggestion.

*Topic:* One commenter urged the Agency to remove requirements that owners and agents collect ethnicity and racial information from applicants.

*Response:* The Agency thanks the commenter for highlighting this important issue. The Agency has modified § 3560.2 to include a disclosure statement about the use of race and ethnicity information that must appear on all applications for housing under sections 514, 515, and 516.

*Topic:* One commenter suggested revising proposed § 3560.2(a)(1) to read: "To refuse to make reasonable accommodations \* \* \*."

*Response:* The Agency appreciates the commenters' suggestion and has revised the interim final rule accordingly.

*Topic:* Commenters also addressed CRCU. Several commenters expressed confusion about the implementation of CRCU.

*Response:* The Agency has added additional information on the circumstances under which CRCU applies. Specific references to the CRCU applicability can be found at §§ 3560.60(c), 3560.69(g), 3560.406(d), 3560.409(b)(3), and 3560.656(e)(1) in the final interim rule.

*Topic:* Several commenters were concerned that capping rents at CRCU will keep rents artificially low in some cases and not address cases in which the costs of operating assisted housing are higher than those for conventional housing.

*Response:* The Agency has addressed this concern by allowing exceptions to the CRCU cap to allow for certain market conditions—extraordinary circumstances when it is in the best interest of the Government as a means to preserve affordable housing

resources. See the references noted above for discussions concerning CRCU.

*Topic:* The Agency received many comments regarding the definition of CRCU. Several commenters believed that the definition in proposed § 3560.11 should refer to the market area, not to the geographic area.

*Response:* The Agency thanks the commenters for this suggestion, but has made no change to the interim final rule. There are regions in the country where the market is small and where Agency-financed multi-family properties comprise the market. By expanding the definition to include the geographic area, this increases the likelihood that there will be compatible rents by which to measure these Agency-financed properties.

*Topic:* One commenter suggested that CRCU should not be used in any county where the median income is lower than the statewide median income.

*Response:* The Agency thanks the commenter for this suggestion but has made no change to the interim final rule. CRCU is designed to work within "market areas" which may cross county lines and is not designed to work within the strictures of a county basis.

*Topic:* One commenter believed that the Annual Financial Report requirement places an additional burden on small projects that is further exacerbated by the CRCU restrictions.

*Response:* The Agency thanks the commenter for this suggestion but has made no change to the interim final rule. Based on the findings of the OIG, the Agency is adding this requirement for smaller projects to address the potential misuse of funds.

*Topic:* Concern was expressed with respect to authority measures, specifically the delegation of authority, as well as exception authority.

*Response:* The Agency understands that commenters are concerned that its requirements be implemented consistently and that the chain of command remain clear when authority is delegated. The interim final rule was designed to maximize consistency in implementing Agency requirements nationwide.

*Topic:* Commenters were concerned that the interim final rule imposes too many restrictions on granting exceptions. Several commenters stated that the proposed rule allows exceptions only when the action is in the best financial interest of the Government.

*Response:* The Agency appreciates these comments and has revised § 3560.8 to read "The RHS Administrator may make an exception to any provision of this part or address any omissions provided that the

exception (1) is consistent with the applicable statute, (2) does not adversely affect the interest of the Federal Government, and (3) does not adversely affect the accomplishment of the purposes of the Multi-Family Housing programs, or application of the requirement would result in undue hardship on the tenants."

*Topic:* One commenter recommended that the USDA hire a national firm to evaluate preservation projects to ensure they are economically beneficial to the Government and, therefore, to tenants.

*Response:* The Agency acknowledges this suggestion but has made no change to the interim final rule. The Agency has an established process and internal procedures and staffing to evaluate the economic benefits of preservation transactions.

*Topic:* One commenter believed that Rural Development employees find it easier to disallow exceptions than to perform the necessary steps to execute an exception.

*Response:* The Agency respectfully disagrees with the commenter's interpretation. Exceptions are evaluated thoroughly on a case-by-case basis and only granted rarely.

*Topic:* One commenter believed that Agency regulations should acknowledge that other financing programs (e.g., tax-exempt bonds, State financing programs, HOME Investment Partnership Funds) may dictate rent levels in addition to the rents dictated by LIHTCs.

*Response:* The Agency appreciates the comment. The Agency has acknowledged these other programs in its descriptions of financial leveraging, third-party financing, and subordination of Agency debt. Numerous commenters raised concerns about some of the definitions provided in § 3560.11, which are described below: Administrative appeals

*Topic:* Several commenters stated that the rule does not contain enough information on when appeals are allowable, to whom appeals should be made, and what are the tenant grievance procedures.

*Response:* The Agency wishes to clarify that the requirements for appeals for all actions, unless otherwise noted in the interim final rule, are found at 7 CFR part 11. The tenant grievance process is described in detail in subpart D and in internal Agency procedures.

*Topic:* One commenter objected to the use of handbooks, notices, or other issuances being a program requirement. The commenter believed that practice subverts the public comment and appeals period otherwise required for regulatory changes.

*Response:* The Agency appreciates the commenter's interest in ensuring a free and open public discussion of public policy but disagrees with the assertion. The regulatory and burden issues are discussed in the interim final rule. Handbooks are useful for providing guidance and establishing internal Agency procedure.

*Topic:* One commenter addressed the issue of environmental reviews. First, with respect to "practicable alternatives," the commenter suggested that the location of a site in relation to flooding, along with the additional cost for insurance and potential development costs, must be addressed in the appraisal. Second, the commenter addressed § 3560.4(e) and noted that lead-based paint requirements are no longer located in 7 CFR part 1924, subpart A; the correct reference is 24 CFR part 35, subparts A–D, J, and R, which are regulations published by HUD.

*Response:* The Agency thanks the commenter for the updated regulatory citations and has updated these references in the interim final rule. However, the Agency has made no change to § 3560.3 of the interim final rule. The suggestion was not adopted because of the existing environmental regulations at 7 CFR part 1940, subpart G.

Numerous commenters raised concerns about some of the definitions provided in § 3560.11, which are described below:

#### Applicant

*Topic:* One commenter suggested that proposed § 3560.55(b) refers to the "applicant," but that "applicant" is not defined.

*Response:* The Agency thanks the commenter for the suggestion and has added a definition for "applicant" to the interim final rule.

#### Asset Management Fee

*Topic:* A commenter believed that the Agency should add a definition for "asset management fee," asking it be defined as a fee allowed to nonprofit organizations or public bodies for the effective ownership of RHS-assisted multi-family housing properties.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. This issue is covered under § 3560.303(b)(1)(ii) and includes a list of expenses that would commonly be charged as an asset management fee.

#### Basic Rent

*Topic:* Several commenters agreed with the change in definition of "basic rent" but were concerned that CRCU

would impose a restriction on the amount of basic rent that borrowers can charge that could adversely affect some properties. Several commenters recommended additional components to be included in the calculation of basic rent.

*Response:* As stated previously, CRCU only applies in certain instances, and the Agency may make CRCU exceptions on a case-by-case basis. CRCU is a concept that the Agency uses to evaluate rent levels. It is not considered the established "rent" or basic rent.

*Topic:* A commenter suggested that in the definition of "basic rent," the Agency should change the last word "agreement" to "subsidy."

*Response:* The Agency appreciates this suggestion; however, the interest credit agreement is the instrument by which any reduction is made.

#### Caretaker

*Topic:* One commenter believed that the definition of "caretaker" should be expanded to state that caretakers may also serve as a site manager, with either an onsite or offsite work location.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. Borrowers may use caretakers or site manager as they see fit, as long as staffing duties and responsibilities are clearly spelled out in the Management Plan.

#### Congregate Housing

*Topic:* One commenter thought that the definition for "congregate housing" should state that such a facility could not be a licensed healthcare facility.

*Response:* The Agency appreciates the comment and has adopted that change in the interim final rule.

#### Current Appraisal

*Topic:* A commenter believed that the definition for "current appraisal" be revised because an appraisal report could be 14 months old and still be a current appraisal report.

*Response:* The Agency thanks the commenter for the suggestion and has revised the interim final rule to state that the appraisal report date should be no more than 1 year old.

#### Default

*Topic:* Several commenters thought that the definition of "default" raised a concern that the Agency could consider a borrower to be in default for minor, insignificant items.

*Response:* The Agency appreciates these comments and has revised the definition to state that default is the failure "by a borrower to meet significant monetary or non-monetary obligations."

#### Disability

*Topic:* One commenter believed that the definition of "disability" is a helpful change, while another commenter believed that the definition is inappropriate.

*Response:* The Agency thanks the commenter for their concurrence on this issue and has clarified the definition in the interim final rule by providing the specific regulatory citations.

*Topic:* One commenter recommended changes to the definition of "disability." The commenter believed that the Agency should either delete the list of examples of a disability, or at least make it clearer that the lists of examples are in no way intended to be exclusive.

*Response:* The Agency appreciates the comment but made no change to the interim final rule because the definition is statutory.

*Topic:* One commenter suggested that the term "handicapped" be replaced by "disabled" or "accessible" whenever appropriate. In limited instances, the use of "handicapped" is acceptable, but the term should be limited.

*Response:* The Agency thanks the commenter for the suggestion and has revised the text as appropriate in the interim final rule.

#### Domestic Farm Laborer

*Topic:* Five comments were received concerning the definition of domestic farm laborer and the proposed rule's elimination of the requirement that aliens be admitted for permanent residence. The majority were in support of the change. One of the commenters contended that Congress has expressed its intent for broader eligibility standards.

*Response:* The requirement that aliens be admitted for permanent residence has been reinserted in the definition. This is required by the authorizing statute, 42 U.S.C. 1484(f)(3)(A). The language concerning the eligibility of a family member was also rewritten to be more consistent with statutory language in 42 U.S.C. 1484(f)(3).

#### Elderly Person

*Topic:* Numerous commenters were concerned that the definition of an "elderly person" includes persons with a disability, and that these persons could be any age. They thought that allowing non-elderly persons to reside in properties designed for the elderly causes social and project management problems.

*Response:* The Agency appreciates these comments but has made no change to the definition because it is statutory.

#### Engagement

*Topic:* One commenter suggested that because the costs of CPA audits are based on the scope of work, the requirements for such engagements must be provided to owners in enough time for the owner to obtain cost estimates from the CPAs and to include the costs in proposed budgets.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. The Agency will provide guidance for borrowers in the MFH Engagement Guidelines to be issued separately.

#### Familial Status

*Topic:* Regarding the definition of "familial status," the commenter recommended that RHS adopt the same definition used in the Fair Housing Act.

*Response:* The Agency thanks the commenter for raising this issue. The Agency is adopting the same definition of "familial status" as used under the Fair Housing Act.

#### Family Farm Corporation or Partnership

*Topic:* One commenter questioned the definition for "family farm corporation or partnership." The commenter asked whether this definition is consistent with other rural development definitions of family farm, particularly the Rural Business-Cooperative Service Business and Industry Cooperative Stock Purchase Program.

*Response:* The Agency thanks the commenter for the suggestion but has made no change to the interim final rule because the definitions are consistent within Rural Development.

#### Farm Labor

*Topic:* The Agency received several comments concerning the definition of "farm labor." Each commenter raised questions about the term "unprocessed stage."

*Response:* The Agency has used this term in the proposed rule instead of the term "manufactured state" in the previous regulation to make the term more consistent with statutory language.

*Topic:* One commenter asked the Agency to include the statutory phrase "without respect to the source of employment" in the definition and to provide examples of what is considered to be farm labor in the handbooks.

*Response:* The Agency has added the statutory phrase to the definition, and the Agency intends to include examples of farm labor in the program handbooks.

#### Farmer and Farm Owner

*Topic:* For the definitions of "farmer" and "farm owner," one commenter found the added reference to 7 CFR

1941.4, which brings in the concept that a farmer must be a "family-size farm," to be a very limiting and improper restriction. This commenter believed that farm laborers should be able to occupy farm labor housing regardless of whether the farm they work for is "family size."

*Response:* The Agency thanks the commenter and has deleted the reference to 7 CFR 1941.4 from the interim final rule.

#### General Overhead

*Topic:* Two commenters asked whether RHS imposes maximum limits for general overhead.

*Response:* There is a maximum limit on general overhead. This maximum limit is 4 percent of the construction cost. RHS establishes a maximum limit that is similar to the standards used by other government lenders. This upper limit can vary with the types of financing used for a project or due to changes in market conditions. The ceiling only serves as an upper limit to help ensure cost reasonableness and can vary across circumstances and over time.

*Topic:* The Agency received a comment stating that the proposed rule should require documentation to ensure that the resident assistant is truly needed for the well-being and care of the tenant.

*Response:* The Agency appreciates the comment but has made no change to its interim final rule. Section 3560.104(c)(4) of the interim final rule provides guidance for borrowers to permit resident assistants. This is a reasonable accommodation issue and should be treated like other reasonable accommodation issues.

*Topic:* One commenter asked why Plainview, Texas, and Altus, Oklahoma, are singled out for consideration in terms of 2000 U.S. Census data.

*Response:* These communities are authorized by statutory language in section 520 of the Housing Act.

#### General Requirements

*Topic:* The commenter thought that performance and payment bonds, cost certifications, and building permits are not considered "general requirements" by the industry and need to be left out of the definition.

*Response:* The professional architect on the Agency's staff disagrees with the commenter and feels the items mentioned are part of "general requirements" by the industry and no change is needed in the definition.

#### Household Furnishings

*Topic:* A commenter questioned the definition of "household furnishings," believing household furnishings should not include tables, chairs, dressers, and beds.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. The commenter needs to consider that these items are necessary for tenants of Farm Labor Housing occupied primarily by migrant farmworkers.

#### Household Member

*Topic:* The commenter thought that the proposed rule and the handbooks should be reconciled and should clarify their definitions of "household member."

*Response:* The Agency appreciates the comment and will revise Agency guidance about program procedures to be consistent with the regulation. No change to the interim final rule was needed.

#### Identity-of-Interest

*Topic:* Numerous commenters stated that the definition of "identity-of-interest" is too broad.

*Response:* The definition of IOI has been moved from the existing regulations to 3560 without change and it is consistent with the one used by other Government lenders.

*Topic:* Some commenters stated that the trigger for an identity-of-interest to occur of 10 percent or more interest in the supplying entity was a reasonable threshold. Other commenters thought that the threshold was either too high or too low.

*Response:* The Agency appreciates these comments. However, the Agency has decided to retain the definition as presented in the proposed rule. The concept of identity-of-interest, as it relates to specific issues, is discussed in more detail in subpart C. Therefore, the Agency has determined that retaining a general description in § 3560.11 is appropriate.

#### Legal or Qualified Alien

*Topic:* One commenter requested that the Agency use the Single-Family Housing definition for "legal or qualified alien," which the commenter finds clearer.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. The definition used in the proposed rule was the same as the definition that is used by the Single-Family Housing Program (see 7 CFR 3550.10) and is consistent with the Housing Act of 1949, section 501(h). The Agency has exercised its authority

under sections 501(h) and 510(k) of the Housing Act of 1949 [42 U.S.C. 1471(h) and 1480 (k)] to restrict eligibility for occupancy in all section 515 projects to citizens and qualified aliens. In addition, eligibility for the migrant farm workers programs under sections 514 and 516 is specifically restricted to such individuals by section 514(f)(3)(A) of the Housing Act of 1949 [42 U.S.C. 1484(f)(3)(A)].

#### Life-Cycle Cost Analysis

*Topic:* Several commenters expressed approval of the Agency's decision to require life-cycle cost analyses under certain circumstances. Others, however, expressed concern about the definition's lack of specificity.

*Response:* The Agency appreciates these comments and has clarified the life cycle cost analysis in § 3560.11.

*Topic:* One commenter addressed the wording in the definition for "life-cycle cost analysis." The commenter believed that the Agency should say Licensed Engineer or Architect rather than Design Professional.

*Response:* The Agency thanks the commenter for this suggestion but has made no change to the interim final rule. The Agency does not want to limit the borrower's option regarding preparation of the analysis.

#### Limited Partnership

*Topic:* Two commenters suggested that "capitol" be revised to "capital" in the definition for "limited partnership."

*Response:* The Agency thanks the commenters for the suggestion and has revised the interim final rule.

#### Management Fee

*Topic:* Regarding the definition of "management fees," one commenter asserted that the proposed rule will use occupied units as the basis for all fees—an approach that is not in keeping with normal industry practices \* \* \* and fails to recognize that vacant units are typically the ones that require the greatest amount of management attention and effort.

*Response:* The Agency acknowledges the commenters' concerns. However, the Agency believes the rule as written takes into account partial occupancy at § 3560.102(i)(2). If additional staff time is needed to perform leasing activities to address vacancies, these costs are payable directly from the project. For this reason, the Agency believes that a fee system based on occupied units will not adversely affect projects experiencing vacancies or higher turnover. Further, if a property is located in a difficult market, the Agency can authorize add-on fees as a means to

address issues associated with individual markets in an area. The Agency has made no changes to the rule, but will continue to consider options and refinements during the interim final rule.

#### Maximum Debt Limit

*Topic:* The commenter supported the inclusion of the reduction of funding available to the borrower from sources other than the Agency in the definition of the "maximum debt limit."

*Response:* The Agency appreciates the commenter's support.

#### Migrants or Migrant Agricultural Laborers

*Topic:* Several commenters stated that the definition for "migrants" and "migrant agricultural laborers" should be clarified to provide a definition of "temporary residence." Others stated that the definition should exclude the requirement that to be migrant, the farmworker would have to travel out of state, and that in large states such as California, this requirement is not practicable.

*Response:* The Agency acknowledges these comments but notes that the definition states that farmworkers may still be considered "migrant" if they are "day-haul agricultural workers whose travels are limited to work areas within one day of their residence." In addition, the term "temporary residence" is discussed more fully in § 3560.553 of the interim final rule.

#### Moderate-Income Households

*Topic:* Several commenters stated that the Agency's definition of "moderate income" is not used by any other affordable housing program and that the Agency should adopt HUD's definition.

*Response:* The Agency appreciates the commenters' concerns but has chosen to use the definition from the Single-Family Housing program for consistency within Agency programs.

#### Mortgages

*Topic:* One commenter suggested that a definition for "deed of trust" should be added. The term "mortgage" is defined, but because many of our multi-family housing loans are secured by a deed of trust rather than a mortgage, deed of trust should also be defined.

*Response:* The Agency appreciates the comment and has clarified its definition of "mortgage" to include deed of trust in the interim final rule.

*Topic:* One commenter recommended that the definition of "mortgage" be modified by adding the phrase "that requires judicial foreclosure for

enforcement" to the end of the definition.

*Response:* The Agency appreciates the comment but has made no change to the definition because not all states require judicial foreclosure for enforcement.

#### Native American

*Topic:* Several comments addressed the definition of "Native American." The commenters believed that the reference to the Indian Self-Determination & Education Assistance Act as the trigger for eligible status is confusing and results in a burdensome search to find this information.

*Response:* The Agency thanks the commenters for the suggestion. The Agency has revised the interim final rule to define the term "Indian tribe" and provides appropriate reference to the Indian Self-Determination & Education Assistance Act. In addition the definition of "Native American" is statutory under section 501(b)(6) of title V of the Housing Act of 1949 (42 U.S.C. 1471(b)(6)).

#### Net Recovery Value

*Topic:* A commenter wrote in support of the definition for "net recovery value."

*Response:* The Agency appreciates the commenter's concurrence.

#### Nonprofit Organization

*Topic:* Numerous commenters expressed concern that the definition of "nonprofit organization" is too prescriptive and will cause too many organizations to be considered ineligible for the priority purchaser category in preservation transfers. For instance, in large states such as California, nonprofit organizations that have the capacity to develop and operate affordable MFH properties are often not local in nature. Commenters were concerned that such restrictions would limit the participation of capable nonprofit organizations in the development and operation of sections 514, 515, and 516 properties.

*Response:* The Agency appreciates these comments and has simplified the definition of nonprofit organization to be less prescriptive and to allow for more widespread participation by nonprofit groups, but the definition remains consistent with the applicable statute. Similarly, the interim final rule provides a separate definition for "nonprofit organization for section 515 program for prepayment or purchase" that is substantially simplified to allow for greater participation in these activities.

#### Note Rent

*Topic:* Several commenters expressed concern that the definition of "note," for note rent, should acknowledge that it stands for the term "note rate rent."

*Response:* The Agency has included the definition for "note rent" in § 3560.11 of the interim final rule, and the correct term for this rent is "note rent."

#### Permanent

*Topic:* A commenter questioned why the term "permanent" was eliminated. The commenter wondered whether the intent is that tenants who are here with temporary legal status papers be housed.

*Response:* The Agency thanks the commenter for the suggestion and notes that there was an error in the proposed rule. The text has been revised as appropriate in the interim final rule.

#### Plan I

*Topic:* One commenter stated that the definition for "Plan I" can be more specific by saying interest credit became effective in 1968.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule because the Agency does not believe the additional specificity provides any more clarity to the definition.

#### Prepayment

*Topic:* One commenter recommended providing further clarification for the definition for "prepayment" by adding "as authorized by the Agency in response to an offer from the borrower."

*Response:* The Agency appreciates the comment but has not incorporated the suggested language in the interim final rule. The Agency does not believe that the suggested revision adds anything to the definition because full payment of the debt may occur in situations other than the Agency's response to an offer from the borrower.

#### Renovation

*Topic:* One commenter stated that "renovation" is a new term for the program that is barely used in the proposed regulation, so this definition should be deleted.

*Response:* The Agency thanks the commenter for the suggestion and has deleted the definition from the interim final rule.

#### Rent

*Topic:* Several commenters were pleased that the Agency acknowledges that there are many different rent levels in affordable housing finance. One commenter asked the Agency to address the issue of multi-tiered rents.

*Response:* The Agency thanks these commenters for their comments on this issue. The Agency did not address multi-tiered rents in the Definitions because such rents are not permitted in the interim final rule.

*Topic:* One commenter found the definition of “rent” to be redundant with the definition of “basic rent.” The commenter suggested that the definition of “rent” include vacancy and contingent factors, reserve transfers, and owner’s return as defined expenses.

*Response:* The Agency appreciates the comment and has clarified the definition of each type of rent in the interim final rule in § 3560.11 by removing the language in § 3560.202(c). The Agency did this because it believes the language from the Housing Project Budget Form provided clearer wording for a definition of this term.

#### Rental Assistance

*Topic:* One commenter suggested that the definition for “rental assistance” be revised to read: “The portion of approved shelter cost paid by the Agency to compensate a borrower for the difference between the approved shelter cost (basic rent) and the tenant contribution when such contribution is less than the basic rent.”

*Response:* The Agency has accepted the comment and has revised the definition for “rental assistance” in § 3560.11 of the interim final rule.

*Topic:* One commenter suggested revisions to “rental assistance units,” specifically, expanding the definition of servicing units to include RA units provided to an operational project for any reason.

*Response:* The Agency thanks the commenter for the suggestion and has revised the interim final rule at § 3560.11.

*Topic:* The Agency received one comment that asks for explanatory guidance as to what a season is. For example, in Oregon seasonal farm labor housing is occupied typically up to 10 months. In other states or regions it may be only as long as 6 or 7 months.

*Response:* The Agency appreciates the comment but has decided not to add this term to the interim final rule. As stated by the commenter, seasons vary by region and therefore, the Agency is allowing the borrower to have the flexibility to deal with this issue. Section 3560.568 of the interim final rule requires the borrower, in their management plan, to establish specific opening and closing dates for off-farm labor housing operating on a seasonal basis.

#### Resident or Site Manager

*Topic:* Regarding the definition for “resident or site manager,” the commenter recommended replacing the portion of the definition that currently reads: “who lives at or near the project site.” The commenter believed that maintaining a local presence is a critical element in providing an acceptable level of customer service.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule because a site manager is a manager who works at the property but is not required to live at or near the property. The Agency does not believe there is a connection between local presence and good customer service.

#### Rural Area

*Topic:* A few commenters expressed concern that basing the definition of “rural area” on decennial census population data is inappropriate because the data are now several years old. Another commenter suggested that the definition was too complicated.

*Response:* The Agency appreciates these comments but has made no change to the definition of rural area because it is statutory, from section 520 of title V of the Housing Act of 1949.

*Topic:* One commenter asked the Agency to add a provision that allows for the automatic revision of the definition of “rural area” as statutes change. This commenter was also concerned with the definitions of sections 515, 514, and 516 programs.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. The definition is statutory and will be changed when the statute is amended.

#### Tenant Contribution

*Topic:* One commenter suggests that in the definition for “tenant contribution,” the word “rent” be replaced with the words “shelter cost.”

*Response:* The Agency thanks the commenter for the suggestion and has revised the interim final rule.

*Topic:* The commenter believed that the definition of “tenant contribution” implies that all tenants pay something for occupancy at a rental unit; however, some tenants do not pay anything.

*Response:* The Agency appreciates the comment and has reworded the definition of “tenant contribution” to use the same definition that was used previously. Under the statutory definition (42 U.S.C. 1471(a)(5)(A)) of income, some items are excluded from the calculation of income; therefore, the commenter is correct that some tenants do not pay any rent.

#### Tenants’ Rights

*Topic:* One commenter suggested that the regulation should include an explicit statement that state or local laws that give tenants greater rights than this regulation are not preempted by the regulation or handbooks, as long as those laws do not interfere with the fundamental purposes of the RHS programs.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. Throughout subpart D of the interim final rule, the Agency states that borrower policies regarding occupancy and tenant rights must be consistent with state and local laws.

*Topic:* One commenter acknowledged that no per-unit square footages was proscribed. The commenter stated that this will help in dealing with multifunding sources; however, developing modest housing should still be a priority with the Agency.

*Response:* The Agency thanks the commenter for the support.

*Topic:* Regarding design requirements, one commenter agreed with the change in philosophy from cost containment to economical construction.

*Response:* The Agency thanks the commenter for the support.

*Topic:* The Agency received a comment regarding owner responsibility and requirements. The commenter believed that this provision is confusing and may be interpreted too broadly. Implicitly this rule provides that parties cannot delegate responsibility, which is not accurate.

*Response:* The Agency appreciates the comment but has made no change to the interim final rule. The borrower is contractually bound to meet the Agency’s requirements by the promissory note, loan agreement/ resolution, and mortgage. The borrower is permitted to hire a management company to perform day-to-day oversight of the property, but the borrower is ultimately responsible for the property.

*Topic:* One commenter addressed § 3560.60(d)(2) and the definition of “to the extent possible” as it relates to accessibility upgrades when a single damaged unit is being extensively repaired. The commenter suggested that if accessibility requirements would add more than 5 percent to the repair costs, the accessibility requirement should not be required. Further, the Agency should note that borrowers could use reserve funds for additional accessibility requirements.

*Response:* The Agency appreciates the comment but has made no change to the

interim final rule. See the reference at § 3560.2(a)(2) that the Uniform Federal Accessibility Standards are required (49 CFR part 1190).

#### Total Development Costs

*Topic:* Numerous commenters were concerned that the components of total development costs do not include developer fees. One commenter suggested that household furnishings be removed from the total development cost.

*Response:* For Agency-financed projects with LIHTC financing, the developer will continue to earn developer fees. Developers of projects without LIHTC financing will not be permitted developer fees. The Agency believes that the borrower's permitted return as currently calculated should provide sufficient remuneration on a well-managed property. Furnishings, as noted in the Definition, are only part of the total development cost for section 514 and 516 (Farm Labor) Housing.

#### Subpart B—Direct Loan and Grant Origination

*Topic:* Numerous commenters expressed concern that the definition of and restrictions on nonprofit organizations are too restrictive. Several commenters said that the requirement for a nonprofit to have 25 members from the community to show community support for the project is excessive because finding 25 people in any community to actively serve is difficult. Some commenters stated that the requirements were unclear. For instance, several commenters asked for a definition of public sector, when used to describe restrictions on the number of board members from the public sector.

*Response:* As stated in the description of the comments received for subpart A, General Provisions and Definitions, the Agency has revised the definition of "nonprofit organization" to be simpler, less prescriptive, and less restrictive to maximize participation of nonprofit organizations in the sections 514, 515, and 516 programs.

*Topic:* Similar to the comments received on the definition of "total development costs," numerous commenters stated that developer fees should be an allowable expenditure of loan funds. Several commenters noted their belief that developer fees should be capped.

*Response:* Again, the Agency's position is that for Agency-financed projects with LIHTC financing, developers will continue to receive developer fees. Developers of projects without LIHTC financing will not be permitted developer fees. (This is

described in § 3560.63(d)(2) of the interim final rule.) The Agency believes that a borrower's permitted return as currently calculated should provide sufficient remuneration on a well-managed property.

*Topic:* The Agency received multiple comments on the requirements for initial operating capital and the initial equity contribution required of borrowers, as well as the time period during which the initial operating capital may be repaid to the owner. One commenter asked the Agency to revise the proposed language in § 3560.64(b) to state that any additional initial operating expenses paid by owners above this amount would be repaid, as a priority, from available cash flow. A second commenter asked the Agency to clarify in § 3560.64(c) why it would require the initial contribution of operating to be made prior to the start of construction. The commenter asked the Agency to revise these requirements so that the initial operating contribution could be provided at the end of the construction period, or at least after construction is 50 percent completed.

*Response:* As outlined in § 3560.304, the purpose of initial operating capital (IOC) is to provide a source of capital for start-up costs. IOC may only be used to pay for approved budget expenses. The applicant's ability to fund the IOC, if required, is part of the applicant eligibility requirements and therefore, cannot be contributed after loan approval, e.g., at the end of construction or at 50 percent completion. The 2 percent IOC requirement is a minimum. If excess funds are contributed to the IOC, they may be withdrawn by borrower in accordance with § 3560.304(c).

*Topic:* Several commenters said that the amount of the initial operating capital—2 percent of total development costs—is unrealistically high.

*Response:* The Agency has determined that 2 percent of total development costs is reasonable in light of the amount required to operate an Agency-assisted property, especially during the initial rent-up period, during which the amount is used to help cover startup costs.

*Topic:* Some commenters said that the 2- to 7-year time period during which the initial operating capital may be repaid to the owner is too long, while others said it was too short.

*Response:* The Agency appreciates these comments but has decided that the 2- to 7-year repayment period is acceptable because it allows adequate flexibility to borrowers. Therefore, the Agency has made no change to the regulation.

*Topic:* Regarding the requirements for general partners in a limited partnership with LIHTCs, 12 commenters stated that the requirement for general partners to have a 5 percent financial interest in a limited partnership, as stated in § 3560.55(d)(2), is unworkable. They stated that in the majority of LIHTC deals, the general partners only have a financial interest of 1 percent or less.

*Response:* The Agency believes that the commenters are confusing the expression "financial interest in the residuals or refinancing proceeds" with "financial ownership interest." The two expressions are distinct, whereby having a 5 percent interest in the former does not preclude having a 1 percent interest in the latter. Therefore, the Agency has made no change to this section.

*Topic:* Numerous commenters stated that the pre-application and initial application submission requirements were too onerous and asked the Agency to clarify its position since they could not clearly understand the proposal. For example, one commenter recommended two annual Notices of Funding Availability (NOFAs) rather than one to promote accelerated use of USDA funds and to allow for more units to be produced on a 6-month versus 12-month cycle. Some commenters were concerned that the Agency considered additional technical assistance as an ineligible use of funds.

*Response:* In developing the NOFA process with the three application stages, the Agency has endeavored to streamline the process by minimizing the application requirements during the pre-application phase when project approval is unknown to reduce the applicants' burden. Likewise, the Agency is requiring the minimum amount of information to be submitted during the initial application phase to reduce the applicants' burden. However, the Agency has a responsibility to collect enough information about proposed projects at each stage to allow for reasonable decisionmaking and effective underwriting. Therefore, the Agency has made no further changes to this section.

*Topic:* Some commenters said that requiring the Agency to conduct an environmental review during the pre-application phase, when it is still uncertain whether the project will receive funds, is unrealistic.

*Response:* The Agency believes that the commenters misunderstood § 3560.56. This paragraph states that environmental reviews are required during the initial phase of loan processing to aid in determining project eligibility and feasibility.

*Topic:* Several commenters asked the Agency to define "State Consolidated Plan."

*Response:* The Agency agrees with the commenters and has added this definition to § 3560.11 of the interim final rule.

*Topic:* Some commenters said that the Affirmative Fair Housing Marketing Plan should not be required for submission during the initial application stage but should be part of the final application submission.

*Response:* The Agency believes the commenters misunderstood the procedures in the handbook. The form used for this plan is given to the applicant during the initial application stage, but the applicant does not need to submit the plan until the final application stage. The Agency has clarified this point in § 3560.56(h) of the interim final rule.

*Topic:* Several commenters stated that the Agency should allow flexibility in requiring applicants to be in full compliance with any existing loan and grant programs, particularly in the case of property transfers and preservation, wherein the new owner entity should not be punished for taking on a property with physical, financial, or managerial issues, or under a preexisting workout plan of less than 6 months.

*Response:* The Agency realizes that achieving and maintaining compliance are challenges under these circumstances. The Agency recognizes these challenges, and program procedures allow RHS to accept a revised workout plan from the new owner that it deems acceptable under the standards in § 3560.453 of the interim final rule and in the Project Servicing Handbook. Also, an exception may be requested by the State Director and considered by the Agency on a case-by-case basis.

*Topic:* The Agency received several comments regarding its position on purchasing excess land, such as when a seller owns 5 acres and will only sell all of the acres, regardless of how much the applicant wants to develop. Commenters stated that there should be flexibility in the Agency's policy so that excess land can be purchased if the applicant cannot find a smaller parcel to purchase and develop.

*Response:* The Agency recognizes the need for flexibility on this issue and is willing to work with applicants in determining the suitability of sites for development. Funds may be used to purchase and improve the site on which multi-family housing will be located, provided that the amount of loan funds used to purchase the site does not exceed the appraised market value of

the site immediately prior to purchase. The regulations at § 3560.54(a)(11) allow borrowers to purchase land for a site in excess of what is needed, except when the applicant cannot acquire an alternate site or cannot acquire the needed land as a separate parcel. The applicant agrees to sell the excess land as soon as practical and to apply the proceeds to the loan. Program site density requirements must be met in accordance with the site requirements established under § 3560.58.

*Topic:* Several commenters expressed concern about the difficulty in locating appropriate sites for development and the need for flexibility in the Agency's criteria. One commenter asked the Agency to clarify its language by changing "will" to "should" in § 3560.58(a)(4). Commenters also said that clarification is needed regarding what constitutes an established rural community/eligible site. Many acceptable sites are located outside city limits but have water, sewer systems, and fire protection. Several commenters said that the regulation requires sites to have reasonable access to water and sewage removal, but this statement appears to negate the use of onsite septic systems as outlined in the Loan Origination Handbook, which describes when alternatives to "community" systems may be used.

*Response:* The Agency appreciates these comments; however, RHS has not made the suggested change from "will" to "should" in § 3560.58(a)(4). The Agency wants to emphasize that it will not approve sites that are not an integral part of a residential community and do not have reasonable access, either by location or terrain, to essential services such as water, sewage removal, schools, shopping, employment opportunities, and medical facilities. Environmental studies and civil rights assessments must be conducted before a site is approved. The Agency wants to emphasize that it remains flexible pending the outcome of such site assessments and the review of final development costs and plans.

*Topic:* Several commenters felt that more consideration should be afforded for development within 100-year flood plains, provided adequate flood insurance is maintained, and for development near or adjacent to industrial sites and processing plants, provided there are no threats of health hazards.

*Response:* The Agency appreciates these comments. However, the Agency will not approve sites subject to 100-year floods when non-floodplain sites exist. Where there are no non-floodplain sites available, sites located within a

100-year floodplain are not eligible for Federal financial assistance unless flood insurance is available through the National Flood Insurance Program. Once all necessary information is collected, analyses are performed, and the appropriate reviews completed for these sites, the Agency will make its decision based on whether the proposed project furthers the program's objectives and the government's interests are adequately protected.

*Topic:* Numerous commenters expressed concern that the Agency does not consider standards imposed by other financing sources, such as tenant income restrictions and tiered rents. Some commenters appeared to be confused about tax credits as a funding source.

*Response:* The Agency appreciates these comments and is committed to working to reduce interprogram differences to the extent practicable, thereby making it easier to satisfy the requirements of other funding sources. Moreover, as noted in § 3560.66(a)(3) of the interim final rule, the Agency will allow the strictest interpretation of the policy to prevail in most instances when requirements conflict.

*Topic:* Several comments focused on the Agency's preference for loan applications with leveraging. Commenters stated that the Agency should not award points, or should award fewer points, to applicants with "token" financing that makes up a very small percentage of total development costs.

*Response:* The Agency understands the commenters' position and notes that how points are awarded is discussed in the Agency's annual NOFA. It is not changing how it scores and ranks applications at this time. Moreover, it already awards fewer points to applications wherein there is a lower percentage of leveraging in comparison to the total development costs.

*Topic:* The Agency received numerous comments on equity requirements for subsequent loans. One commenter stated that the Agency should change its language in proposed § 3560.55(d)(1) to read "borrower," not "equity." Several other commenters stated that requiring a borrower to make an equity contribution for a subsequent loan is a disincentive for applying for the loan. Others said that the equity contribution should come from the property's resources.

*Response:* The Agency appreciates these comments and has changed its language in § 3560.55(d)(1) of the interim final rule to read "borrower," but it will not change its position. RHS does not consider it an onerous

requirement for applicants for subsequent loans to make an equity contribution of 3 or 5 percent, depending on whether the project is being financed with LIHTCs.

*Topic:* A substantial number of commenters focused on the required funding level of a property's reserve account and felt that the minimum deposit requirement was too high. These commenters were concerned that this requirement would be unduly costly and result in budget-based rents exceeding conventional rents for comparable units.

*Response:* The Agency appreciates these concerns. Since the proposed rule was published, RHS has undertaken a comprehensive property assessment of the properties in the section 515 portfolio. The preliminary results provided useful information for reconsidering the extent of capital reserves that may be necessary to meet the capital needs of projects and to explore policy options for addressing these needs to be reflected in any necessary budgetary and legislative changes. More time is needed to properly address these matters. Accordingly, RHS has decided to publish an interim final rule that does not include these provisions—specifically § 3560.103(c)(3) and § 3560.306(k)(1) of the proposed rule—until their impacts can be assessed and policy decisions can be made for a long-term strategy.

*Topic:* Several commenters believed that there were loopholes in the proposed rule that would have enabled a borrower to commit deliberate actions to force the Agency to accelerate the borrower's loan to circumvent the preservation/prepayment requirements.

*Response:* The Agency notes that similar comments were addressed in subpart N and recommends referring to this part of the interim final rule for more information. However, it does note that in the interim final rule, the Agency modified § 3560.456(a) to read as follows: "Before accelerating a project loan, the Agency will consider the possibility that the borrower is forcing an acceleration to circumvent the prepayment process. If it is found that this is the borrower's motivation, the Agency will consider alternatives to acceleration, such as suing for specific performance under loan and management documents."

*Topic:* The Agency received numerous comments on the restrictive-use provisions described in this subpart. Several of these comments focused on how the proposed rule was unclear about whether use restrictions remain in effect or terminate on properties whose

borrowers make their balloon payment and pay off their Agency debt when the 30-year term expires. Some commenters expressed concern that if the use restrictions do not remain in effect for the entire 50-year loan amortization period, the supply of affordable housing will decrease. Other commenters said that the restrictive-use provisions should expire when the borrower pays off the Agency debt.

*Response:* As explained in the preamble to the proposed rule, use restrictions are tied to the 30-year term of the mortgage. This requirement was established in 7 CFR part 1944, subpart E and the proposed rule simply continued this policy. However, the Agency notes that its interim final rule would allow properties to remain in the program if the borrower sought and obtained additional financing from the Agency upon expiration of the term.

*Topic:* Several commenters expressed dissatisfaction with the Agency's policy for calculating returns on investment. Some commenters recommend that the full 8 percent return should be allowed on all equity funds up to 10 percent of the amount of the initial investment instead of just on the 3 or 5 percent initial contribution. These commenters also felt that consideration should be given for older projects.

Other commenters noted that the Agency should allow a return based on the current value of the original investment adjusted for inflation, if owners are expected to maintain a business commitment to MFH projects.

*Response:* The Agency has considered the commenters' reasons for suggesting higher returns but has retained the policy described in the proposed rule, which is consistent with the Agency's existing policy in 7 CFR part 1944, subpart E on this topic.

*Topic:* Additional commenters noted that the Agency does not account for inflation when estimating return on investment in § 3560.68. (One noted that the reference to § 3560.67 was wrong and should be § 3560.68.) They also felt that there needed to be provisions for the payment of general partner fees for MFH projects with LIHTCs consistent with the LIHTC industry standard.

*Response:* The Agency has corrected the cross reference in the interim final rule. As is the case with the payment of developer's fees on combined MFH/LIHTC-financed projects, general partner fees, while not an eligible use of Agency loan funds, may be included in the total development costs when such fee is paid from other financing sources, in accordance with § 3560.63(d)(2).

*Topic:* Several commenters noted that the definition of security value of the

property is critical to the calculation of return on investment. If security value equals "value-in-use," the return on investment will be greater than if the security value of the property equals the market value.

*Response:* The Agency acknowledges these comments and has made revisions to the language in § 3560.68 to address this concern. The Agency also has noted that clarifications were made in § 3560.752 of the interim final rule to reduce confusion about the types of value determinations.

*Topic:* The Agency received comments regarding its cost certification requirements, which state: "Whenever the State Director determines it appropriate, and in all situations where there is an IOI as defined in 7 CFR 1924.4(i), the borrower, contractor and any subcontractor, material supplier, or equipment lessor having an identity of interest must each provide certification as to the actual cost of the work performed in connection with the construction contract." Several commenters stated that these requirements were not strict enough and suggested requiring further cost certifications. Another commenter recommended that the regulation should specify an audit by a CPA, who is independent from the borrower. Another commenter asked for clarification about some of the related procedures, and who pays for the audit.

*Response:* The Agency appreciates these comments and has included a clarification in § 3560.72(b) of the interim final rule that cost certifications must be prepared in accordance with 7 CFR part 1924, subpart A. The Agency believes this clarification provides the necessary protection. Further, the Agency, rather than the borrower, has the authority to contract with a CPA to perform the audit. RHS believes that the language in the rule is clear—the expenses related to the cost certification and the accompanying audit are paid by the borrower out of loan proceeds. If the Agency contracts for the audit, it pays for the cost, and the loan funds for this cost are returned. This process is described in Agency guidance about program procedures.

*Topic:* Several commenters supported the elimination of the designated places requirement. The commenters said that the designated places list frequently excludes areas where the need for affordable housing is the greatest. Commenters said that if a market study indicates a need for affordable housing in a given area, the Agency should consider the project for funding, even if the location is not on the designated places list.

*Response:* The Agency is committed to using its funds to benefit households with the greatest need for housing in areas where the supply of affordable housing is limited. Further, it believes this commitment is reflected in the designated places list, where designated places is a requirement in accordance with § 532(c) of title V of the Housing Act of 1949, as well as other Agency or Administration priorities.

*Topic:* The Agency received several comments on the regulation's references to accessibility standards. Several commenters suggested that the reference to the ADA be removed because the ADA is not applicable to residential properties. Some commenters expressed confusion about accessibility requirements.

*Response:* The Agency has noted these comments and has removed the references to the ADA, except where it is applicable. The interim final rule continues to reference 7 CFR part 1924, subpart A, which addresses accessibility requirements. Further, Agency staff can help provide clarification about accessibility requirements during the project planning stage.

*Topic:* Other commenters said that the accessibility requirements for on-farm labor housing should be less stringent.

*Response:* The Agency appreciates these comments. However, the Agency has made no change to § 3560.60(d), as its policy on accessible units needs to comply with the applicable civil rights statutes and regulations.

*Topic:* The Agency received several comments on § 3560.56(e), which states that the Agency will process the next initial loan application, in rank order, when an application is delayed for a period of time that will not permit funding of the project during the current funding cycle. The commenters stated that it is very difficult to complete projects within a particular funding cycle given all the development challenges and the need to obtain funds from other sources.

*Response:* The Agency believes that the commenters misunderstood this paragraph. The Agency must be able to obligate the funds for a particular project, not complete the construction process, during the current funding cycle. The Agency recognizes the challenges in preparing an application involving multiple funding sources but has retained the language as written because it must obligate the available program funds within the established period.

*Topic:* Several commenters focused on § 3560.60 (Design requirements), with comments ranging from the specific to the relatively general. For

example, commenters stated that the Agency's requirements for (1) economical construction, operation, and maintenance and (2) life-cycle cost analyses are contradictory, as life-cycle cost analyses can lead to greater maintenance costs. By comparison, a commenter asked the Agency to work with other Agencies to ensure that current threshold requirements are improved to prevent air and water infiltration.

*Response:* While the Agency appreciates these comments, it has made no change to this section because it feels that conducting life-cycle cost analyses will help ensure a balance between economical construction and a property's long-term viability.

*Topic:* Several commenters also focused on the life-cycle cost analysis requirement in § 3560.60 (Design requirements). Some commenters were concerned that requiring a life-cycle cost analysis would not be cost-effective for properties with minor capital needs. Others said that the term "life-cycle cost analysis" should be clarified so that borrowers are fully aware of their responsibilities for obtaining and implementing the results of the analysis.

*Response:* The Agency appreciates these comments, but the life-cycle cost analysis requirements in § 3560.60(c)(3)(iii) of the interim final rule are used in an effort to balance upfront construction costs and long-term operating costs. The Agency has made no change. The Agency provides further information on obtaining and using a life-cycle cost analysis in its guidance about program procedures.

*Topic:* A number of commenters stated that a property's rents should be based on its operating and development costs, which might be higher than conventional rents for comparable units. Several of these commenters stated that it is difficult to find comparable rents in certain communities. Other commenters said that it was difficult to comment on the implementation of conventional rents for comparable units without knowing what the impact will be.

*Response:* The Agency appreciates these comments, but RHS views conventional rents for comparable units as an important underwriting consideration in assessing project viability. As stated previously, the Agency may make an exception to the requirement that rents do not exceed conventional rents for comparable units if doing so is in the Government's best interest.

*Topic:* With regard to the Agency's requirement that its loans be at least 25 percent of a project's total development

costs, some commenters thought that this 25 percent threshold is reasonable, but others said that the threshold should be increased because of the difficulty in servicing small loans.

*Response:* The Agency has considered the commenters' suggestions but has decided to retain the 25 percent threshold. The Agency believes this threshold is reasonable and has not been a problem for the majority of applicants.

*Topic:* Several commenters asked what security value should be used to determine maximum loan limits.

*Response:* The Agency has clarified these terms in the interim final rule so that the terms "current value" and "value-in-use" were replaced by "market value" in § 3560.63(e). Also, a description of market value is provided in § 3560.752 of the interim final rule.

*Topic:* The Agency received several comments regarding the cap of 2 percent of total development costs for section 515 projects and 4 percent for off-farm labor housing projects to cover development/loan packaging. Several commenters said that the 2 percent for section 515 projects and 4 percent for off-farm labor housing projects are not adequate to cover costs, especially in those cases where the developer does not serve as the general contractor. Other commenters contended that development costs for section 515 and off-farm labor projects are roughly equivalent.

*Response:* The Agency acknowledges the commenters' concerns but has determined that there is no compelling reason to increase the cap. Furthermore, in the Agency's experience, development of Farm Labor Housing projects is more difficult than development of section 515 properties. Therefore, the Agency has made no change in the cap for section 515 properties.

*Topic:* Regarding the eligible uses of loan and grant funds as described in § 3560.53, several commenters supported the Agency's more detailed description of allowable costs. Others said that the percentages for allowable builder's profit, general overhead, and general requirements are improved over prior allowances, while others thought that the percentages should be increased to compensate for increased costs. Several commenters said that the section should be more inclusive, while others thought some costs should be prohibited.

*Response:* The Agency appreciates these comments but has made no change to its position in the interim final rule. The comments were very general, and RHS believes the language in the proposed rule is reasonable.

Moreover, the allowable cost percentages were derived as a result of an Agency review of Agency, State, and industry cost information and best management practices. The provisions in the Agency's interim final rule are consistent with the results of this review.

*Topic:* Regarding the language in § 3560.53 on the use of funds to develop and install necessary systems, some commenters felt that certain elements of this requirement were too prescriptive and bureaucratic, ultimately leading to increased development costs. Other commenters said that the installation of necessary systems offsite should require permanent easements.

*Response:* The Agency has considered the commenters' concerns and revised § 3560.53(e)(1) in the interim final rule to read: "The loan applicant will hold title to the facility or have a legal right to use the facility in the form of an easement or other instrument acceptable to the Agency for a period of at least 50 percent longer than the term of the loan or grant and the title or right is transferable to any subsequent owner of the housing."

*Topic:* Other comments regarding § 3560.53 included praise for the clearer, improved statement of authorized purposes. Another commenter stated that the language in § 3560.53(b)(2) was too restrictive and could result in properties without the amenities to effectively compete with other affordable properties in their market area.

*Response:* The Agency thanks the commenters for positively recognizing the improved language. RHS acknowledges the concern about ensuring that properties are competitive. The Agency believes that other provisions throughout subpart B provide sufficient flexibility to enable applicants to develop properties with competitive features and amenities for the area, while at the same time ensuring affordability and reasonable development costs.

### **Subpart C—Borrower Management and Operations Responsibilities**

*Topic:* The Agency received numerous comments on the property maintenance requirements. These comments covered three broad topics, as discussed below.

*Topic:* A number of commenters expressed approval of the Agency's effort to codify property standards. They indicated that the increased clarity will help ensure a consistently higher level of compliance with the standards and provide safer, healthier environments for tenants, especially children.

However, other commenters argued that such specificity should not be included in the regulation, as it can create a lack of flexibility for property owners who must follow the rules over their own judgment about cost-effective maintenance. Some suggested putting the detailed property standards in the program handbooks. One person suggested referencing an industry code.

*Response:* The Agency appreciates these comments and understands the commenters' concerns. The Agency has considered the advantages and tradeoffs of including specific standards in the rule and has decided to keep the specific standards in the rule. By establishing the standards in the regulation, the Agency has a stronger regulatory basis for enforcing property maintenance standards.

*Topic:* Similarly, commenters were concerned that for many properties it would not be practical to achieve and maintain compliance with all items in the list of requirements. They indicated that any single deficiency should not be interpreted as an indication of a poorly maintained project and questioned whether a single or limited number of deficiencies would put them out of compliance. One commenter asked for a specific statement of what would constitute compliance. Commenters also added that ongoing compliance with a long list of requirements would be even more difficult given the limits on operating budgets and stressed the need for adequate resources to meet these property maintenance standards. They suggested that they be allowed to consider the severity of a problem to prioritize their maintenance needs and not be required to address all deficiencies at once.

*Response:* The Agency appreciates all these comments and has modified § 3560.103(a) to indicate that it will not penalize the borrower for not meeting all standards if there is clear evidence that the borrower is working toward meeting 100 percent of the standards. Further, properties in the process of addressing deficiencies will not be deemed out of compliance unless the number of deficiencies constitutes substantial noncompliance and calls into question the viability of the property and the effectiveness of the borrower's maintenance program. The Agency has added language to the interim final rule at § 3560.103(a)(4) indicating that upon discovery of conditions that do not meet the standards, it expects that the borrower will remedy the conditions in a reasonable period of time. The Agency has listed in the interim final rule at § 3560.103 (a)(3)(i) through (xvii) the

standards by which compliance will be measured.

*Topic:* Commenters also had a number of suggestions, proposed language changes, and questions on how to interpret these standards. They had questions on issues ranging from rain diverters and gutters to van parking spots to the caulking of water closet floors and accessible laundry facilities. They suggested edits to the language on water leaks, cracks, moisture and mold, and common area accessibility. They also raised the issue of work order systems and the difficulty of implementing them in small properties.

*Response:* The Agency acknowledges these comments and has made appropriate edits for clarity in the interim final rule at § 3560.103(a)(3)(i) through (xvii). The work order system required is not intended to be any more elaborate than necessary for the size of the property.

*Topic:* Regarding the new approach to management plans, management agreements, and management certifications, many commenters applauded these changes for reducing the administrative burden on both the borrower and the Agency, though a number of commenters were also concerned that the changes might hinder the effectiveness of Agency oversight. Other commenters suggested further streamlining these requirements, and a number of comments asked to see the management certification form. Finally, several commenters noted that subpart C of the proposed rule contradicts itself by stating that management plans are not subject to Agency approval and then stating conversely that Agency approval is required (see § 3560.102(c)).

*Response:* The Agency acknowledges these comments. The Agency has remedied the conflict identified at § 3560.102(c) to clarify that Agency approval of management plans is no longer required. The Agency believes that the concerns about the changes hindering Agency oversight reflect commenters' confusion about the some of the specifics of the new policy. While the Agency is no longer approving either the management plan or the management agreement, the management certification is signed by both the management agent and the borrower, and is approved by RHS. The certification commits the management agent and the borrower to operate the property in compliance with program requirements and provides specific financial and other penalties for failure to comply, including termination of the management agreement. This certification is similar to the document

used successfully in HUD multi-family programs. The Agency believes that this document eliminates unnecessary Agency reviews, while still retaining clear authority for compliance oversight and enforcement.

*Topic:* Commenters made a number of suggestions on how and when to submit management plans and certifications. They asked if current management plans would need to be reviewed and updated for approval, and also, what types of changes in approved plans would require reapproval of the documents; they strongly suggested that only significant changes require reapproval within the 3-year timeframe. One commenter suggested that a borrower with multiple properties should be able to submit a "master file" with a plan for all the borrower's properties. Another asked if the management certification could be done as part of the budget document. Commenters also asked about using a management agreement acceptable to both the Agency and the State finance Agency to help eliminate paperwork.

*Response:* The Agency agrees with the commenters that only significant changes will require resubmission of documents. As noted in § 3560.102(c) of the interim final rule, the Agency will no longer approve management plans. Borrowers will need to prepare and submit updated management plans initially after publication of this rule. Subsequent updates are required when project operations substantially change with regard to the mandatory items in the plan, or if the borrower needs to submit a workout plan and the management plan needs to be updated to be consistent with the workout plan (see subpart J).

*Topic:* Numerous commenters questioned the requirement in § 3560.102(d) that the management plan be updated if the project is found to be out of compliance. The commenters questioned the need to update the management plan in cases where the problem is not due to items covered in the plan and noted that this poses an unnecessary burden.

*Response:* The Agency agrees with the commenters' concern but notes that the paragraph allows borrowers to submit a statement that the management plan is adequate to assure compliance if changes to the plan are not needed to address the violation. Further, the Agency believes that requiring the management plan to be updated to describe how compliance violations are to be addressed is reasonable when such changes would support compliance. Therefore, the Agency has made no

changes to the management plan requirements.

*Topic:* Management fees and the policy for determining allowable fees to be paid out of project income received numerous comments. A number of commenters supported the new method. Some commenters suggested that a base fee using a National average, with add-ons for geographic factors, would help with consistency. However, others expressed strong opinions that the determination of reasonable fee standards could only be done effectively at the State level. Numerous commenters were disappointed that the Agency chose to institute a "per unit, per month" management fee rather than a fee based on a percentage of revenue or gross collections. They were also concerned that much of the clarity gained through the development of Administrative Notices on this topic did not appear in the rule. Many commenters were concerned that any method used to determine a range of base fees for a given area would be seriously flawed. Their concerns included the following:

- Management fees should be determined at the State level because only the state has specific market knowledge to set fees correctly.
- Management fees should be published periodically at specified times. Some commenters worried that the process of publication will delay the release of the fees. They asked that State lists be made available immediately.
- RHS should consider Consumer Price Index when establishing management fees.
- The management fee system should ensure that the appropriate fee ranges are allowed. Some suggested looking at successful State models for per-unit fees.

Commenters also had a number of questions and clarifications regarding the eligibility for fees of Public Housing Authorities, the fees for sections 514 and 516 projects, the bundle of services, and add-on fees and the relationship of these fees to fees in market rate properties.

*Response:* The Agency acknowledges the commenters' concerns and has revised § 3560.102(i) to address clarification issues raised by the commenters. Management fees will be paid based on a "per occupied unit" basis. The Agency feels that this is the fairest methodology at this time. The base fee will be valued on a specific "bundle of services" that has been added to this section. The "bundle of services" has previously been issued in Administrative Notices. Periodically, the Agency through the State Offices

will publish the base fee. The States will determine the base fee using housing industry data for their state. The frequency for updating the fee ranges will be established in Agency program procedures.

*Topic:* The Agency received numerous comments with respect to management agents being allowed to earn a management fee for any unit occupied for at least one day during the month. Several commenters said that allowing for a management fee for a partial month is a welcomed improvement; however, there was disagreement about whether the Agency's information management capabilities would allow it to effectively track monthly occupancy rates, including units that are vacant on the first of the month but occupied later in the month. Some commenters suggested that management agents should only be eligible to receive a fee for a unit that was occupied on the first of a month; in contrast, other commenters argued that occupancy should not even be a factor in calculating management fees. They stressed this method is not the industry standard because vacant units often require more attention than occupied units. In addition, the tracking of occupied units places an additional burden on the management agent. One compromise approach offered was to allow management fees on the total units as long as the property stays 90 percent occupied, and per-unit fees if the property falls below the 90 percent threshold.

*Response:* The Agency acknowledges the commenters' concerns. However, the Agency believes the rule as written takes into account partial occupancy at § 3560.102(i)(2). If additional staff time is needed to perform leasing activities to address vacancies, these costs are payable directly from the project. For this reason, the Agency believes that a fee system based on occupied units will not adversely affect projects experiencing vacancies or higher turnover. Further, if a property is located in a difficult market, the Agency can authorize add-on fees as a means to address issues associated with individual markets in an area. The Agency has made no changes to the rule but will continue to consider options and refinements during the comment period of the interim final rule.

*Topic:* The bundle of services concept established in § 3560.102(i) received many comments and questions. Several commenters asked for more detail on the included list of services. Some expressed concern that this arrangement will add new costs and complexity to the compensation of management

agents, while others strongly endorsed the concept stating that it will help bring clarity and consistency to the process. Commenters stressed that, given the diversity of business practices among agents, the defined bundle of services must be complete, necessary, and consistent among projects, counties, and states. Some commenters asked that a list of charges for each state (for the bundle of services) should be made available for comment before the interim final rule is published.

*Response:* The Agency appreciates these comments and has endeavored to establish a clear, appropriate, and practical delineation of project-related costs and services to be covered out of the management fee, and those costs and services to be paid directly from project income. RHS has developed this definition of the bundle of services for the management fee based on extensive input from stakeholders prior to the rulemaking. The bundle of services can be found at § 3560.102(i)(3) of the interim final rule.

*Topic:* Commenters raised several points about the benefits and potential costs of the prohibition on IOI relationships in the program. Several commenters recommended that IOI relationships between any parties connected to a particular Agency-financed project be prohibited, while other commenters stated that such a prohibition would increase the cost of goods and services for many projects. In addition, several commenters suggested that § 3560.102(g)(2) be revised to state that failure to disclose IOI relationships will subject the borrower, management agent, and any other firms or employees found to have an IOI relationship to suspension and debarment. Still others asked for more guidance on what constitutes an IOI relationship and how to document it.

*Response:* While the Agency acknowledges the commenters' concerns, requirements regarding the disclosure of IOI relationships and documentation that the use of such providers and suppliers is in the best interest of the project are essential program controls to ensure program integrity and reduce the risk of abuse. Further, the Agency's ability to suspend or debar borrowers who fail to disclose IOI relationships is important to enforcing this requirement; however, the Agency reserves the right to use this provision within its discretion. For these reasons, the Agency has made no change to § 3560.102(g) in the interim final rule.

*Topic:* The prohibition of IOI insurance carriers drew many comments. Commenters explained that

with rising insurance premiums, they have fewer and fewer choices for insurance providers. They noted that it is especially difficult to find insurance in rural and tribal areas; many have found that their only cost-effective option has been with carriers that would be considered to have an IOI relationship with the borrower. Commenters emphasized that member-owned risk pools have been a successful strategy for holding down insurance costs, but these, too, are adversely affected by the prohibition on IOIs. Commenters urged the Agency to remove the IOI prohibition with respect to insurance.

*Response:* The Agency has considered these comments and has deleted the requirement under § 3560.105(e) that prohibited borrowers from using IOI insurance carriers. The Agency expects that this change will improve borrowers' ability to obtain Agency-required coverage at a lower cost.

*Topic:* Regarding the Agency's general insurance requirements, several commenters stated that the Agency should not have to deem insurance carriers as "reputable and financially sound." Other commenters recommended that the minimum property insurance coverage should be the replacement value, not the depreciated replacement value. They offered that the alternative of existing debt is acceptable. Commenters also proposed adding language to the regulation on tenant responsibility for "contents" insurance, the use of project revenue for nonprofit organizations' director's liability insurance, and the deposit of checks. Commenters also requested certain changes to language in the rule for clarity regarding insurance minimums and limited insurance. Finally, one commenter expressed satisfaction with the addition of the guidance on policies for several buildings.

*Response:* The Agency appreciates the comments and suggestions, and has made several of the suggested editorial changes to the rule for clarity at § 3560.105(b),(c), and (d). The Agency acknowledges the concerns raised, and while the Agency has decided not to make substantive modifications to its insurance requirements in the interim final rule, the Agency will continue to accept comments and consider them in subsequent policy discussions prior to publishing the final rule.

*Topic:* Commenters also asked RHS to allow greater flexibility with respect to insurance requirements to allow the Agency and borrowers to appropriately respond to changing market conditions. Several commenters expressed strong

concern about rising insurance premiums and identified possible cost-effective alternatives to current insurance policies. They stressed the need for exception authority and suggested that one approach—at the state level grant exceptions to the deductible requirement, while allowing borrowers to put aside funds to self-insure for the difference.

*Response:* The Agency recognizes the cost issues associated with insurance and changes in the insurance industry. Since September 11, 2001, the Agency has been processing deductible exceptions and meeting with industry groups in order to develop a response to higher costs. Therefore, the Agency has increased the maximum allowable deductible to \$10,000 (for property insurance). The Agency has retained the flexibility for increased deductible amounts.

*Topic:* Regarding requirements for insurance deductibles, several commenters stated that the required deductibles were too low and could result in dramatic premium increases. Other commenters said that the deductible limits (of 0.5 percent or \$5,000) were set many years ago and should be adjusted to reflect current industry standards. Finally, several commenters asked for clarification with regard to the language in § 3560.105(f) about how insurance deductible "amounts must be accounted for in the reserve account."

*Response:* The Agency recognizes the commenters' concerns. It has adjusted the deductible amounts to reflect current industry practice and they appear at § 3560.105(f)(8) in the interim final rule.

*Topic:* The Agency received several comments on the requirements for hazard insurance coverage. These commenters asked the Agency to clarify its definition of hazard insurance. For instance, some commenters were uncertain if terrorism or earthquake coverage is required. Several commenters stated that earthquake insurance should not be required as it is prohibitively expensive.

*Response:* The Agency appreciates these comments and has revised the interim final rule to clarify the insurance types required at § 3560.105(f)(1) and (2).

*Topic:* Regarding requirements for liability and fidelity coverage, some commenters said that while the proposed rule provides for minimum liability coverage of \$1,000,000 per occurrence, no deductible is provided in the proposed rule. Similarly, commenters expressed concern that the proposed rule did not provide minimum

coverage amounts and deductibles for fidelity coverage. Commenters also asked that language regarding the breadth of liability coverage be changed to specify the coverage of buildings; grounds; and common, commercial, and other public space. They suggested that language on options for liability coverage, such as errors and omissions and environmental damage, be moved to the Asset Management Handbook. For fidelity coverage, commenters indicated that the provision for reflecting the portion covering the employee in the management plan was not practical.

*Response:* The Agency acknowledges the commenters' concerns. The deductible amounts for fidelity coverage have been included in the interim final rule at § 3560.105(h)(2)(i). The Agency has retained the language from the proposed rule regarding coverage of areas beyond the buildings in the interim final rule and has replaced the language regarding the fidelity premium to state that the premium could be prorated among the housing projects covered. The Agency has not removed the language on suggested coverage as it reflects current industry standards and, as a minimum amount, is not likely to require regular updating.

*Topic:* Several commenters objected to the Agency's requirement that the Agency must be named as co-payee on all loss drafts. These commenters felt that this is a viable requirement only when the Agency is in first lien position. Several commenters said that if the Agency is in the junior lien position, the Agency can be named as an additional insured.

*Response:* The Agency has considered these comments and made appropriate revisions at § 3560.105(b)(4) of the interim final rule.

*Topic:* Regarding the affirmative marketing and accessibility requirements discussed in § 3560.104, one commenter expressed appreciation for the level of specificity provided in the rule, while another stated that further guidance was still needed. Several commenters proposed edits to the language to strengthen and clarify requirements regarding community contacts, the frequency of advertising and the publication of advertisements, the costs associated with fair housing training for staff, and requirements regarding limited English proficiency. Another commenter asked for additional detail regarding accessibility and reasonable accommodations. Finally, several commenters asked for clarification regarding the requirements for updates to the Affirmative Fair Housing Marketing Plan, suggesting that

updates be made only for significant changes.

*Response:* The Agency appreciates the comments and has made the change to clarify organizations for the disabled at § 3560.104(b)(4)(ii)(B) of the interim final rule. The Agency has not made changes to the language on reasonable accommodations and financial burden because it is based on fair housing and accessibility statutes and their implementing regulations. Additional clarification about procedures and determinations regarding reasonable accommodations and Affirmative Fair Housing Marketing Plans are included in internal Agency procedures. Limited English proficiency requirements are addressed in subpart A.

*Topic:* The Agency received a number of additional comments regarding the fair housing and accessibility requirements in subpart C. Commenters noted the importance of these requirements. Several commenters stated that reasonable accommodations should be made at the project's expense, not at the borrower's expense as stated in the proposed rule. Other commenters asked for clarification as to who makes the decision about whether a request for an accommodation causes undue financial or administrative burden, and one asked for a definition of undue burden. Multiple commenters requested a change in the language about persons with disabilities and companion animals to help clarify which tenants can request this accommodation. Other commenters said that the discussion of accessible laundry facilities does not allow for alternate arrangements, as allowed by section 504. Other commenters stated that in the interim final rule, any discussion of common area accessibility must refer to the Uniform Federal Accessibility Standards (UFAS). Still other commenters said that the proposed rule's language defining responsibility for paying for reasonable accommodations is unclear.

*Response:* The Agency appreciates the comments and has changed the language at § 3560.104(c)(4) of the interim final rule to place the financial burden on the property, instead of on the borrower, and further clarifies this responsibility.

*Topic:* The discussion of required signage drew many comments. Some suggested language changes to clarify the requirements. Others questioned the need for such extensive guidance on these topics. Still others questioned about the applicability of the requirement and whether existing signs had to be changed to meet the requirements or local requirements.

*Response:* The Agency acknowledges that the ten requirements listed under § 3560.104(d) are very specific but does not consider these requirements to be onerous. Further, the Agency believes that this detail is appropriate to help ensure compliance with applicable Federal fair housing and accessibility requirements. Therefore, the Agency has retained these requirements in the interim final rule.

*Topic:* Several commenters disagreed with the language in certain paragraphs in subpart C that referred to the ADA. The commenters correctly noted that these paragraphs should refer to section 504 of the Rehabilitation Act of 1973 because most areas in residential properties are not regulated under the ADA.

*Response:* The Agency thanks the commenters for highlighting this issue and has removed the identified references to the ADA from the interim final rule.

*Topic:* Regarding policies related to payment of property taxes, some commenters stated that the Agency should not require the borrower to certify that the property's taxes were paid because some states have services that notify USDA of property tax delinquencies. Several other commenters suggested that instead of requiring the Agency to pay property taxes when the borrower fails to do so, the Agency should determine whether it is in the best interest of the Government to pay the delinquent taxes.

*Response:* The Agency appreciates these comments and removed the requirement at § 3560.105(i) for borrowers to certify the payment of property taxes from the interim final rule. However, this certification will remain as a requirement for the annual financial statements. The Agency has considered the suggestion regarding property taxes but believes that it is not prudent as a general policy to relax the requirement for keeping the property tax payment current. More guidance on the annual financial statements will be provided by the MFH Engagement Guidelines to be issued separately.

*Topic:* The Agency received a number of comments on the qualifications for acceptable management agents. Some commenters approved of the requirements, while others suggested that it may be difficult to find management entities with the required 2 years of experience in many rural areas. Other commenters questioned whether this requirement is unnecessary for small properties. One commenter suggested broadening the requirement to allow experience managing LIHTC properties to satisfy the experience

requirement. One commenter suggested requiring the prospective management agent to disclose all past RRH properties managed as evidence of past performance.

*Response:* The Agency understands the commenters' concerns but has retained the experience requirement. RHS believes that successful experience with some type of federally assisted affordable housing is important for effective project management because the program rules require specialized knowledge beyond conventional property management. The Agency notes that experience managing LIHTC projects would be acceptable experience.

*Topic:* There were also comments on the 45-day approval timeframe for management agents. Some commenters agreed with it or suggested lengthening it to 90 days to allow the Agency more time for review. Others stated that the approval timeframe, with 30-day interim authorizations, for new agents is too long for a project without a management agent and suggested that the Agency should simply accept the agent and provide approval after the change has taken effect.

*Response:* The Agency understands the commenters' concerns about getting new management agents in place quickly but also needs to allow adequate time for Agency review of a prospective agent's experience and acceptability. In balancing these two considerations, the Agency has decided to retain the proposed timeframes in the interim final rule.

*Topic:* The Agency received several comments on the requirement for resident participation in property management. The commenters were concerned that the wording implies that residents have a role in decisions regarding property operation beyond input and suggestions. They stated that while resident input is helpful, borrowers' financial responsibilities also give them full responsibility for operations.

*Response:* The Agency emphasizes that the borrower has ultimate responsibility and, therefore, decisionmaking authority in the property. The intent of the tenant participation requirement is only to provide an opportunity for tenant input into the management process, not a role in making decisions.

*Topic:* One commenter suggested adding a requirement to the rule requiring language in the management agreement that clearly establishes a management agent's responsibility and liability for any equity skimming it causes or allows to happen.

*Response:* The Agency does not have a direct relationship with the borrower's management agent and cannot hold such agents directly responsible for these activities. The Agency relationship is with the borrower and, as such holds the borrower responsible for all activities at Agency-financed properties.

#### **Subpart D—Multi-Family Housing Occupancy**

*Topic:* The Agency received a substantial number of comments on lease and occupancy terminations. Several commenters said that the regulation should acknowledge that some tenants are displaced through no fault of their own and describe the tenants' rights in these situations.

*Response:* The Agency thanks the commenters for this suggestion and has modified the interim final rule. Specifically, the Agency has modified § 3560.159(c) to state that tenants whose leases are terminated through no fault of their own are entitled to benefits under the Uniform Relocation Act.

*Topic:* Several commenters said that once a termination notice is given to the tenant to vacate, the tenant's recourse should be through the court system. To allow a tenant to provide a corrective action plan will only increase the termination time of problem tenants. Other commenters said that the proposed regulation still excludes evictions from the grievance process but also eliminates the written warning requirement and the right to meet with the borrower to discuss the alleged lease violation and possibly the termination notice itself.

*Response:* The Agency has modified § 3560.159(a) to state that the borrower must give the tenant written notice of the violation and give the tenant the opportunity to correct the violation prior to terminating a lease.

*Topic:* The Agency received several comments that recommend revised language regarding the termination of occupancy in § 3560.159(a)(1). One commenter suggests that § 3560.159(a)(1)(i) be revised to read: "Violations of lease provisions or occupancy rules which are substantial and/or repeated." The commenter also suggested revisions to § 3560.159(a)(1)(ii), specifically, removing "beyond the grace period."

*Response:* The Agency thanks the commenter for the suggestions and has changed the above referenced sentences as recommended at § 3560.159(a)(1)(i) and (ii) in the interim final rule.

*Topic:* Several commenters wanted the current regulation to better specify residents' rights and borrowers'

obligations. Specifically, the commenters identified the following:

- The proposed regulation eliminates the requirement that the borrower notify the tenant of the right to review the borrower's file and copy information from it.

- RHS streamlining efforts have gone too far in the eviction or termination section of the proposed rule. RHS should revise the termination section by adding back the language about tenants' rights and obligations from the current regulation and stating these rights in a precise and clear manner that residents can understand.

- RHS should make it clear to its borrowers that the rejection or eviction of otherwise eligible applicants or tenants may cause borrowers to violate the Fair Housing Act, title VI of the Civil Rights Act of 1964, and other civil rights laws.

*Response:* The Agency acknowledges the commenters' concerns. The issue regarding the tenant's right to review the borrower's file is described in the interim final rule at § 3560.160(g)(4). The Agency has amended 7 CFR 3560.159 to include additional tenant protections with respect to termination. The civil rights laws to which borrowers, tenants, and the Agency are bound are described in 7 CFR 3560.2.

*Topic:* Multiple commenters praised the Agency for drafting the proposed rule to give new latitude to USDA to issue Letters of Priority Entitlement when required repair or rehabilitation causes displacement. The commenters believed that this added authority is helpful.

*Response:* The Agency appreciates the commenters' support.

*Topic:* One commenter advised the Agency to include "major loss or destruction by fire" as another example of conditions that could lead to termination, even if temporary until the housing can be restored for occupancy.

*Response:* The Agency acknowledges the commenter's concern. The situation described is referenced in 7 CFR 3560.159(c), which states that a tenant's occupancy may be terminated in the event of a building rehabilitation or a natural disaster. This paragraph further explains the tenant's rights under these circumstances.

*Topic:* Commenters stated that material lease violations should not be attributed to innocent members of the household, particularly in cases of domestic violence.

*Response:* The Agency notes the commenters' concerns. However, termination of tenancy terminates the lease of the unit and not specific household members.

*Topic:* Comments were received regarding the Agency's prohibitions against noncitizens. Several commenters contended that if enacted, the regulation would have a negative impact on many existing tenants who are not eligible noncitizens. This, in turn, will have a negative impact on the projects themselves. One commenter asked whether noncitizens could live in section 515 properties.

*Response:* While the Agency acknowledges the commenters' concerns, restricting occupancy in sections 514, 515, and 516 properties to U.S. citizens and legal immigrants is a statutory requirement.

*Topic:* The Agency received one comment recommending that RHS expand its proposed definition of legal or qualified alien to include three classes of immigrants that Congress recently determined should be eligible for public benefits, including "public and assisted housing" under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.

*Response:* While the Agency appreciates the commenter's suggestion, it has made no change because the definition of a legal alien is statutory per 42 U.S.C. 1436(a). The Agency has exercised its authority under sections 501(h) and 510(k) of the Housing Act of 1949 [42 U.S.C. 1471(h) and 1480(k)] to restrict eligibility for occupancy in all section 515 projects to citizens and qualified aliens. In addition, eligibility for the migrant farm worker programs under sections 514 and 516 is specifically restricted to such individuals by section 514(f)(3)(A) of the Housing Act of 1949 [42 U.S.C. 1484(f)(3)(A)].

*Topic:* Several comments were received regarding the proposed rule's citizen requirement for the head of household. First, the commenter indicated that RHS's proposal to require the head of household to be a citizen or a permanent resident violates section 501(h) of the Housing Act of 1949. In addition, the commenter asserted that HUD has not conditioned eligibility to reside in its housing upon an adult member being a citizen or a person legally admitted for permanent residency. Finally, the commenter urged RHS to clarify language in § 3560.152 to indicate that only one member of a household need be a citizen or legal or qualified alien.

*Response:* The Agency acknowledges the commenters' concerns, but it has made no change because the requirement for occupants of sections

514, 515, and 516 housing to be citizens or legal immigrants is statutory.

*Topic:* With regard to § 3560.152(a)(1) and § 3560.154(a)(7), a comment was received suggesting that USDA incorporate appendix 2 to the HUD Handbook 4350.3. Further, the commenter urged USDA to coordinate with the Department of Homeland Security in much the same manner as HUD.

*Response:* The Agency thanks the commenter for this suggestion. Appendix 2 to the HUD Handbook 4350.3 is incorporated into internal Agency procedures.

*Topic:* Several comments were received regarding the acceptance of income-ineligible tenants into section 515 properties. Several commenters noted that if enacted, the Agency would require the borrower to publish local notices when waivers are granted to allow a project to rent to ineligible tenants. They thought that § 3560.152(d) was an unnecessary, excessive, and costly requirement to impose on what are presumably vacancy-troubled projects.

*Response:* The Agency notes the commenters' concerns and has removed this requirement from the interim final rule. In the proposed rule, it was located at § 3560.152(d)(3).

*Topic:* Regarding § 3560.152(d)(4), commenters believed that borrowers should not be required to submit monthly reports to the Agency regarding marketing efforts to locate eligible tenants. Instead, records should be kept onsite for review during Agency inspections.

*Response:* The Agency thanks the commenters for raising this issue and has modified the interim final rule so that the monthly report submission is not required. In the proposed rule, this was located at § 3560.152(d)(4).

*Topic:* Regarding § 3560.152(e), commenters generally argued that the move-in date should be the effective date for tenant certification, which is the first of the month.

*Response:* The Agency provides rental assistance, if available, to eligible tenants as of the first day of the tenant's first full month of occupancy. Therefore, the recertification date is the first day of the month for which the tenant is eligible to receive the subsidy. The Agency has made no change to the interim final rule.

*Topic:* One commenter asked what "prevailing market rent rate" means as referenced in § 3560.152(d)(8).

*Response:* The Agency appreciates the commenter's question. The Agency has removed this reference from § 3560.152(d) of the interim final rule.

*Topic:* Several commenters addressed ineligible tenant waivers with regard to the lease term, as well as the Farm Labor Housing rent. First, with regard to lease terms, commenters acknowledged that the proposed rule calls for one-year leases to ineligible tenants followed by a month-to-month lease thereafter. The commenters recommended that the lease to ineligible tenants should simply be month-to-month. In terms of Farm Labor Housing rent, the commenters believed that income-ineligible tenants should be expected to pay the greater of the one percent note rent or prevailing market rent, not the lease rate of one percent in the proposed rule. The Agency received one comment suggesting that over income residents should be required to move after the expiration of the current calendar year or 90 days, whichever is later.

*Response:* The Agency acknowledges the commenters' concerns. The Agency allows a 1 year lease for ineligible tenants because not allowing an ineligible tenant to remain in the unit for at least 1 year could result in an undue financial burden to that tenant, and in many localities, contravenes State or local law. The Agency believes, however, that once the year elapses, it is fair to require the ineligible tenant to move within 30 days if this is stated in the lease and does not contravene State or local law. The Agency has removed the reference to prevailing market rate rent.

*Topic:* Regarding § 3560.152(d)(7), one commenter suggested that this paragraph be deleted. Other commenters indicated that requiring a 25 percent surcharge for a Plan I projects, which operate at market rents, would require the borrower to charge rents higher than the market and consequently hurt project occupancy.

*Response:* The Agency appreciates the commenters' concerns but has made no change to § 3560.152(d)(7) because the requirement is not a change from existing policy, which merely requires that ineligible tenants pay a higher rent than eligible tenants.

*Topic:* One commenter addressed § 3560.152(e)(1)(iv) and asked for clarification regarding the ineligibility consequences faced by tenants who fail to comply with tenant certification.

*Response:* The Agency appreciates the commenter's concern. The interim final rule states that tenants who fail to recertify are no longer eligible for occupancy and subject to termination of tenancy in Agency MFH programs covered by the interim final rule. The interim final rule (at § 3560.152(d)) also explains how ineligible tenants may

continue to be housed and the regulations concerning their occupancy.

*Topic:* Multiple comments were received asking that any change in tenant eligibility should grandfather in existing tenants.

*Response:* The Agency notes the commenter's concern; however, any changes in tenant eligibility requirements will not grandfather in existing tenants. Existing tenants should not be affected by changes in eligibility requirements, until their upcoming recertifications. Further, the Agency's internal procedures provide guidance for existing tenants.

*Topic:* One commenter said that allowing borrowers to "temporarily rent apartments to all persons without regard to age or income restrictions" appears to violate the exemption from the prohibitions against discrimination because of familial status that was granted to RHS.

*Response:* The Agency does not agree with this commenter's assessment. Ineligible tenants are permitted for temporary periods to protect the financial interest of the Government. No change was made to the interim final rule.

*Topic:* Several comments were received on tenant grievance procedures. These commenters said that the Notice of Adverse Action is specifically listed as a category of action a tenant or prospective tenant may grieve. The commenters went on to say that new language defines a Notice of Adverse Action as a proposed action that may have adverse consequence for tenants or prospective tenants, whereas in the prior regulation it was not clearly defined, and that notice delivery requirements were excluded from the proposed rule.

*Response:* The Agency appreciates the commenters' recommendations and has included delivery requirements at § 3560.160(e) of the interim final rule.

*Topic:* Several commenters asked the Agency to include a provision that when the tenant and the borrower disagree as to whether something is grievable, the dispute should be viewed as a threshold question to be decided before the Hearings Officer or panel.

*Response:* The Agency has made no change to the interim final rule. The actions that are grievable are identified at § 3560.160(d) of the interim final rule.

*Topic:* One commenter suggested that the proposed regulation indicate that the tenant has a right to grieve the borrower's action or inaction when it involves the borrower's failure to comply with lease terms or rules.

*Response:* The Agency acknowledges the commenter's concern. Section

3560.160(b)(2) lists the circumstances under which a borrower's action or inaction is not grievable. Borrower's failure to comply with lease provisions or rules would fall under § 3560.160(b)(1) of the interim final rule.

*Topic:* The Agency received a few comments regarding compliance with § 3560.103 and a tenant's right to grieve. One commenter believes the standards contained in the proposed rule are too broad. For example, the commenter cited § 3560.103, which indicates that failure to maintain the premises in such a manner that provides decent, safe, sanitary, and affordable housing is grounds for a grievance. The commenter interpreted this to mean that residents would have a right to a grievance hearing if they thought the landscaping was not attractive. Another commenter believed that these standards should be posted or handed out to tenants at the time a lease agreement is executed.

*Response:* The Agency acknowledges the commenters' concerns. The Agency cannot prevent nuisance or frivolous grievance filings but has attempted to outline realistic standards of property maintenance that are expected of borrowers. Additionally, the Agency does not believe it is necessary to require borrowers to provide these standards to tenants as part of the lease. The standards are contained in § 3560.103 of the interim final rule.

*Topic:* One commenter addressed the issue of grievances based on discrimination against protected classes (§ 3560.160(a)(2)). According to the commenter, this paragraph includes marital status and sexual preference as protected classes, which is unlike any other Federal law. The commenter believes there is no apparent need to have greater fair housing provisions than in other Government programs.

*Response:* The Agency thanks the commenter for raising this issue. The Agency has revised the language in this section to include only the protected classes as specified under Federal law. Marital status and sexual preference have been removed from § 3560.160(a)(2) in the interim final rule.

*Topic:* Several comments addressed grievances that may involve discrimination. One commenter suggested that language should be added to § 3560.160(a)(2) to clarify that discrimination complaints should be filed with the Regional Fair Housing and Equal Opportunity Office of HUD. Another commenter suggested that discrimination grievances could be handled under § 3560.160, if the grievant so desires.

*Response:* The Agency thanks the commenters' for these suggestions and

has modified the language in § 3560.160(a)(2) to state that any tenants or potential tenants who feel that they are being discriminated against may present a complaint to the U.S. Department of Agriculture's Office of Civil Rights.

*Topic:* One commenter suggested that the process outlined in § 3560.160 may be abused and used merely for delay. The commenter recommended allowing an exception where the owner determines that a resident poses a risk to health and safety to other residents and property staff.

*Response:* While the Agency recognizes the commenter's concerns, the Agency has a responsibility to ensure that all tenants have equal protection under civil rights and fair housing laws. Tenants have the right to participate in a grievance process when they feel that they have been treated unfairly by a borrower or agent of the borrower in an Agency-assisted MFH property. Section 3560.160(b)(2) makes it clear that tenants who engage in unlawful behavior that threatens the health and safety of other tenants may not take advantage of the grievance process once the termination action has been initiated. The Agency has made no change to the interim final rule.

*Topic:* One comment addressing § 3560.160(h)(2)(iii) recommended that the right of a tenant to confront and cross-examine witnesses during the hearing be specifically included in § 3560.160(h)(2)(iii) because both the current and the proposed regulations include such a right for the borrower.

*Response:* The Agency thanks the commenter for this suggestion and has made the change to § 3560.160(h)(2)(iii).

*Topic:* The Agency received a comment regarding § 3560.160(g)(4) expressing concern that this section limits a tenant's inspection of the documents, records, and policies a borrower intends to use at a hearing to a "reasonable time before the hearing." The commenter believed that the regulation must include a timeframe in which the borrower is required to disclose their evidence before the hearing so that the tenant has adequate time to prepare for the hearing.

*Response:* The Agency acknowledges the commenter's concern, but believes that, "reasonable time before the hearing" is clear. In this instance, a reasonable time is that which allows the tenant adequate time to use the information to the benefit of his or her case against the borrower. The Agency has made no change to § 3560.160(g)(4) of the interim final rule.

*Topic:* Several comments were received regarding fair and impartial

hearing procedures. Specifically, the commenters recommended that the regulation:

- Require Hearing Officers to be “impartial and disinterested.”
- Include the prohibition against the Agency’s appointing a Hearing Officer who was earlier considered by either party to ensure the integrity of the process.
- Include the language of the current regulation, which prohibits a Hearing Officer from being paid, unless done so by the Agency.

*Response:* The Agency acknowledges the commenters’ concerns and has incorporated the suggestions into § 3560.160(g)(2) of the interim final rule.

*Topic:* The Agency received several comments urging time limits for certain actions. Specifically, the commenters recommended that the new regulation:

- Impose a time limit on a borrower to submit the summary of the informal meeting to the tenant. This would be similar to the proposed regulation, which imposes a 10-day time limit on the tenant to request a hearing after receipt of the summary (§ 3560.160(g)(1)).
- Include a specific timeframe in which the borrower is required to submit a summary of the meeting to both the tenant and the Agency.
- Impose a requirement on the borrower to prove receipt of the Response to a Notice of Adverse Action.
- Change the 10-day Response time for grievances regarding lease modifications.

*Response:* The Agency acknowledges the commenters’ concerns. Section 3560.160(f) of the interim final rule has been revised to provide for a 10-calendar day time frame for the borrower to provide a summary of the informal meeting. The Agency has also imposed a requirement on the borrower to prove receipt of the Response to a Notice of Adverse Action. The Agency did not change the 10-day Response time for lease modifications. No justification was provided by the commenter for the change.

*Topic:* One comment addressed § 3560.160(f)(3) and noted that language contained in the current regulation required the borrower to include certain information in the summary submitted to the tenant, but this language was left out of the proposed rule. The commenter recommended that this language be retained in the new regulation.

*Response:* The Agency acknowledges the commenter’s concerns and has incorporated this requirement at § 3560.160(f)(3) of the interim final rule.

*Topic:* The Agency received multiple comments on how borrower/tenant communications, such as Notices of Adverse Action, waiting list decisions, and eligibility decisions should occur. One commenter urged that communications be sent via certified mail. Another commenter suggested that communications be sent by regular mail to the last known address. Other commenters urged that phone contact be made.

*Response:* The Agency acknowledges the commenters’ concerns. Section 3560.160 of the interim final rule provides direction for borrower/tenant communications in those areas where tenant rights are concerned. The Agency would prefer that borrowers establish the most efficient communication system for their property.

*Topic:* Several commenters urged that any notice from the resident to the owner or management must be in writing.

*Response:* The Agency appreciates the commenters’ concerns. The Agency has added language in § 3560.160(f) of the interim final rule that tenants or prospective tenants must file grievances in writing.

*Topic:* One comment recommended that the rule state that any tenant or prospective tenant seeking occupancy in a housing project may complain to the Secretary of Agriculture.

*Response:* The Agency thanks the commenter for this suggestion and has modified the interim final rule’s language in § 3560.160(a) to state that any tenants or potential tenants may present a complaint to the U.S. Department of Agriculture’s Office of Civil Rights, which Agency is the receiver of all complaints.

*Topic:* One commenter suggested that § 3560.160 should be deleted. According to the commenter, residents already have leases and lease rights, landlord/resident law, the legal right to form associations, and access to the regulatory Agency, so the additional processes outlined in § 3560.160 are duplicative and burdensome.

*Response:* While the Agency recognizes the commenter’s concerns, it has a responsibility to ensure that all tenants have equal protection under civil rights and fair housing laws. Tenants have the right to participate in a grievance process when they feel that they have been treated unfairly by a borrower or agent of the borrower in an Agency-assisted multi-family housing property.

*Topic:* The Agency received a comment regarding § 3560.160(f)(2) stating that the 5-calendar-day timeframe for the meeting requirement

by the borrower is rather short. The commenter believed that this time limit should be extended to 10 days.

*Response:* The Agency thanks the commenter for this suggestion and has incorporated it into § 3560.160(f)(2) of the interim final rule.

*Topic:* One commenter cited § 3560.160(i)(2), which indicates that the notice must state that the decision is not effective for 10 days to allow time for an Agency review as specified in paragraph (i)(3) of this section. The commenter recommended that this section clarify that the 10 days are calendar days. Second, the commenter believed that the reference to (i)(3) appears to be wrong and should be (i)(4).

*Response:* The Agency thanks the commenter for this suggestion and has changed the interim final rule to clarify that the 10 days are 10 calendar days. The Agency has made the other editorial changes as well.

*Topic:* The Agency received a comment regarding § 3560.160(g)(5) recommending that 15 calendar days are used, rather than 15 days. Also, in terms of escrow deposits, the commenter suggested a new section be added that requires that the grievant notify the borrower of his intention to escrow funds and the name of where the funds are being held.

*Response:* The Agency acknowledges the commenters’ concern and has added “calendar” to clarify the time period. The Agency believes § 3560.160(g)(6)(iv) of the interim final rule provides the guidance for the tenant providing proof of escrow deposit information.

*Topic:* A commenter addressed the failure of either party to appear at a scheduled hearing (§ 3560.160(h)(5)). The commenter believed that postponement of the hearing should not be an option when either party has failed to appear at a scheduled hearing.

*Response:* The Agency appreciates the commenter’s concern but has made no change to this provision so that both the borrower and the tenant have ample opportunity to defend their respective positions.

*Topic:* The Agency received multiple comments regarding the importance of resolving disputes without litigation. The commenters believed that the regulation leaves tenants without adequate protection and leaves borrowers without a clear process to resolve lease compliance issues without litigation. One commenter suggested that without a dispute resolution process, borrowers and tenants will be forced into litigation and resident evictions will increase.

*Response:* The Agency acknowledges the commenters' concerns. However, the Agency believes that adequate protections are afforded to the tenant in the interim final rule, including a grievance process, and that borrowers have appeal rights in certain situations. The Agency believes that its policy and accompanying procedural guidance provide ample protection for borrowers and tenants.

*Topic:* One commenter recommended involving tenants and advocates in the rulemaking process.

*Response:* The Agency recognizes that the position of tenants and advocates is very important to the proper implementation of the regulation. Tenants' representatives were included in stakeholder meetings prior to the development of the rule and their input was considered by the Agency as it developed the proposed rule.

*Topic:* Several commenters stated that the proposed requirement that adverse decisions be issued in English as well as other languages when the area contains a concentration of non-English speakers is overly burdensome.

*Response:* The Agency acknowledges the commenters' concerns but has made no change to the language in the interim final rule because requirements concerning limited English proficiency of applicants and tenants are civil rights issues and are covered under § 3560.2(b).

*Topic:* Several commenters stated that applicants with incomplete applications should not be entered on the waiting list.

*Response:* The Agency appreciates these comments and has modified § 3560.154(f)(4) of the interim final rule to state that tenant selection will be made from the applicants on the waiting list with completed applications.

*Topic:* Several commenters addressed requirements about specifying both a time and a location when applications can be taken, as well as office hours in key documents. Specifically, multiple commenters believed that the requirement to list the office times on the management plan and Affirmative Fair Housing Marketing Plan should be removed because it is burdensome to the borrower and managing agent to update these documents often as office hours change. Other commenters expressed concern about having to maintain regular office hours in small projects to take applications, especially since many are submitted by mail; maintaining office hours in small projects can be costly.

*Response:* The Agency acknowledges the commenters' concerns and has revised § 3560.154(c) of the interim final

rule to eliminate the requirement to maintain a place for accepting applications to provide more flexibility to smaller projects. However, borrowers still need to announce when and where applications will be taken (in rental advertisements) and document this information in the management plan and the Affirmative Fair Housing Marketing Plan because this information needs to be formally documented to establish compliance with key fair housing requirements. This is required in § 3560.154(c) of the interim final rule.

*Topic:* One commenter addressed § 3560.154(g)(2)(ii), believing that the definition of "displaced" is not clear. The commenter suggested creating a definition of displaced in § 3560.11.

*Response:* The Agency acknowledges the commenter's concern but has not added a definition of "displaced" because the definition is contained in the Uniform Relocation Act, which is applicable to all Agency MFH properties.

*Topic:* The Agency received several comments regarding the automation of forms and waiting lists. The commenters believed that the continuation of this practice should be permitted. Another commenter advocated a waiting list cap.

*Response:* The Agency appreciates the commenters' concerns and has undertaken substantial automation initiatives recently. The commenter did not provide a justification for establishing a waiting list cap, therefore no change was made to the regulation.

*Topic:* One commenter suggested revising § 3560.152(e)(1)(iii) to read: "Tenants must report to borrowers all changes in their household status that may affect the tenant's eligibility."

*Response:* The Agency thanks the commenter for this suggestion and has made the suggested change to § 3560.152(e)(1)(iii) of the interim final rule.

*Topic:* One commenter recommended that in § 3560.152(e)(2) the Agency should require borrowers to use wage-matching techniques to confirm tenants' income. The commenter believed that this practice should be done at initial certification and at each annual recertification.

*Response:* The Agency notes the commenter's suggestion. Wage matching is an internal Agency procedure and not available to borrowers.

*Topic:* One commenter addressing the 10-day standard in § 3560.152(e)(2)(iii) recommended that in certain circumstances this standard should be waived.

*Response:* The Agency acknowledges the commenter's suggestion, but no

change has been made because § 3560.8 of the interim final rule describes the requirements for administrator exceptions.

*Topic:* Several comments were received on the Agency's policy of collecting race and ethnicity data on applications for occupancy. Several commenters said that the proposed rule requires applicants to provide this information on the application form and if they elect not to do so, the owner is required to note applicants' race/ethnicity and sex on basis of visual observation or surname. In addition, several commenters noted that applicants' race and/or ethnicity should not appear on the waiting list. Further, some commenters urged that if race and/or ethnicity appear on the waiting list, then gender should be included as well. One commenter said that listing the race categories in alphabetical order is problematic. This text is based on 7 CFR part 1900, subpart A, and the **Federal Register** Notice entitled "Revisions to the Standards for the Classification of Federal Data on Race and Ethnicity" published October 30, 1997.

*Response:* The Agency thanks the commenters for highlighting this important issue and has modified § 3560.154(a)(9) of the interim final rule to include a disclosure statement about the use of race and ethnicity information that must appear on all applications for housing under sections 514, 515, and 516. Applicants are not required to provide this information. The Agency requires the waiting list to include race and ethnicity information for statistical purposes only.

*Topic:* One commenter addressed § 3560.154(f) and recommended that computer-generated waiting lists should only be allowed if the program does not allow names to be deleted or inserted. The commenter believes that otherwise computer-generated waiting lists are open to manipulation and civil rights data are not accumulated.

*Response:* The Agency appreciates the commenter's concern but it notes that in § 3560.154(i) of the interim final rule and irrespective of the form (*i.e.*, electronic or nonelectronic), the Agency requires borrowers to document their purging procedures in the project's management plan. To further address the commenter's concern, the Agency added language to this same paragraph establishing minimum standards regarding these procedures that will allow Agency review of borrower management of the waiting list to check for such concerns.

*Topic:* One commenter disagreed with the requirement that applicants must

certify that the unit will be their permanent residence as stated in § 3560.154(a)(7). The commenter argues that this rule will not work for migrant families and urges the Agency to revise the language.

*Response:* The Agency wishes to clarify its position. Section 3560.154(a)(7) states that the applicant must certify that the unit will be the household's primary residence, not its permanent residence.

*Topic:* One commenter suggested a revision to § 3560.154(a)(2) regarding "the number of household members and their ages." The commenter suggested that this be changed to "number of household members and their dates of birth."

*Response:* The Agency appreciates the commenter's suggestion and has incorporated this change into § 3560.154(a)(2).

*Topic:* One commenter addressed § 3560.154(a)(10) and did not believe that individuals have a "taxpayer identification number."

*Response:* The Agency appreciates the comment and has changed this item to refer to the individual's social security number.

*Topic:* Several commenters voiced their approval of § 3560.152(a)(3), which makes a household eligible if it qualifies for and is receiving housing benefits through another program, such as section 8 or the Low-Income Housing Tax Credit (LIHTC) program.

*Response:* The Agency thanks the commenters for their support of this provision.

*Topic:* Regarding § 3560.154(g), commenters expressed concern that there is no mention of the right of borrowers to give priority to LIHTC-eligible tenants if the project is operated under the LIHTC program, or any mention of the right to leave a unit vacant if no LIHTC-eligible applicant is available.

*Response:* The Agency recognizes the commenters' concerns and has included language regarding selection of applicants in LIHTC projects at § 3560.154(d) of the interim final rule.

*Topic:* Comments were received that addressed the Agency's requirements to establish occupancy policies related to unit sizes. Numerous commenters stated that the proposed rule was not clear about the borrower's responsibilities toward residents who are over-or underhoused. Some commenters asked whether these families would be required to move from the project. Others suggested that basing eligibility on unit size could potentially be construed as a violation of applicable civil rights laws. Another commenter

recommended that any decision on unit size should be given in writing and should contain specific references to the grievance process.

*Response:* The Agency appreciates these comments and has deleted the requirement for borrowers to establish a minimum threshold of one person per bedroom for each rental unit from § 3560.155 (e). Families who are over-or underhoused will be required to move into the first appropriate size unit available at the property, not to vacate the property altogether.

*Topic:* One commenter questioned the proposed regulation regarding occupancy policies in § 3560.155 because it deletes references to "fair housing concepts" such as reasonable accommodation. The commenter recommended that these concepts remain in the regulation.

*Response:* The Agency thanks the commenter for raising this issue and has added references to reasonable accommodation to § 3560.155(e)(3) of the interim final rule.

*Topic:* The Agency received multiple comments on § 3560.156(c)(1)(iii) and § 3560.156(c)(15)(xiii) expressing concern about increasing the extended tenant absences from two weeks to four weeks. One commenter recommended that the definition of extended tenant absences remain at two weeks and not be increased to four weeks.

*Response:* The Agency thanks the commenters for highlighting this issue. The reference to the time period for extended absences has been deleted from the interim final rule. The Agency believes this is an occupancy rule that is best determined by each property. It is not a regulatory definition. The borrower has the right to decide what constitutes an extended absence as long as the definition is consistently applied to all tenants.

*Topic:* Several comments specifically focused on § 3560.156(c)(15)(xx) of the proposed rule. One commenter suggested that the Agency delete examples of good cause and note that good cause varies based on local practices. In addition, two commenters addressed the lease requirements contained in § 3560.156(c)(15)(xx). The commenters recommended that the Agency specify a distance that represents a good cause move to another location, such as 100 miles.

*Response:* The Agency acknowledges the commenters' concerns and has deleted the examples of good cause from the interim final rule.

*Topic:* The Agency received several comments regarding § 3560.156(c)(15)(iii) of the proposed rule, which requires the owner to accept

a tenant's net contribution. One commenter urged greater flexibility in how borrowers are allowed to apply these funds to amounts owed by the tenant. Other commenters recommended that this section be revised so that the owner must first apply funds to back rent and any damages, then current rent. A commenter believed that this would limit property abuse.

*Response:* The Agency acknowledges the commenters' concerns and has revised the interim final regulation at § 3560.152(c)(8) to clarify that the tenant contribution should first be used for rental charges.

*Topic:* One commenter addressing § 3560.156(c)(15)(iii) of the proposed rule argued that the proposed regulation and handbook sections pertaining to leases and occupancy rules do not adequately cover security deposits. The commenter thought that the new regulation should place limits on security deposits, allow residents to contribute to the deposit over a period of time, require the owner to place the deposits in segregated escrow accounts, and require that leases contain information consistent with provisions of State law regarding the use, collection, and disposition of security deposits.

*Response:* The Agency appreciates the commenter's concern, but this information is contained in § 3560.204 of the interim final rule.

*Topic:* Multiple comments were received regarding displaced tenants in cases where a unit is uninhabitable in § 3560.156(c)(15)(xviii) of the proposed rule. One commenter urged that RHS modify the regulation to make clear that tenants who are displaced from units when they become uninhabitable have a first right to return to the unit after it is rehabilitated unless the owner has terminated the residency for good cause. The second commenter acknowledged that both the current and proposed regulations require that the lease contain a provision about disposition of a lease when a unit becomes uninhabitable. Further, commenters suggested that the proposed regulation clarify that termination of the tenancy and the subsidy are two different issues, and that both require written notice and a hearing.

*Response:* The Agency appreciates the commenters' concerns. While the Agency has made no change to this section in the interim final rule, it has modified § 3560.159(c) to state that any tenant displaced due to a unit being uninhabitable is eligible for benefits under the Uniform Relocation Act. Section 3560.159 refers to termination

of tenancy only; termination of subsidy is discussed at § 3560.259(c) of the interim final rule.

*Topic:* The Agency received one comment about § 3560.156(c)(15)(ix) of the proposed rule suggesting that the Agency clarify the proposed rule to indicate that the tenant may not be evicted for failure to pay charges other than rent or utilities. Instead, the commenter suggested that the borrower should be limited to other legal action to collect those charges.

*Response:* The Agency acknowledges the commenter's concern. However, the Agency believes it is appropriate for termination of occupancy based on material noncompliance with lease requirements and has retained this language at § 3560.159(a)(1)(ii) of the interim final rule.

*Topic:* Several comments addressing the 30-day move out requirement in § 3560.156(c)(1)(i) of the proposed rule recommended that this paragraph allow tenants to move out either within 30 days or at the end of the term of the lease, whichever is greater, which would agree with language in § 3560.158(b).

*Response:* The Agency acknowledges the issue raised by the commenters and has revised the interim final rule so that the requirement is consistent with the language in § 3560.158(b).

*Topic:* The Agency received a comment about § 3560.156(c)(1)(iv) of the proposed rule, acknowledging the requirement that tenants make restitution when unauthorized assistance is received but expressing concern that the proposed rule does not differentiate between the unauthorized assistance being the fault of the tenant or the borrower.

*Response:* The Agency appreciates the commenter's concern. The Agency has moved references to unauthorized assistance due from the borrower or from the tenant to subpart O of the interim final rule.

*Topic:* One commenter addressing § 3560.156(c)(15) of the proposed rule recommended that the lease include a statement that tenants agree that they will be held financially responsible if they receive any excessive Government subsidies because of their failure to report their accurate income, income changes, true members of the household and their incomes, or any other improper actions.

*Response:* The Agency acknowledges the commenter's concern. The certification form that tenants are required to sign includes the penalties for fraudulent reporting of income. This issue is further addressed in subpart O of the interim final rule.

*Topic:* One commenter suggested month-to-month leases rather than year-long leases.

*Response:* The Agency has made no change to this provision because it has always required a minimum one-year initial lease term for all its MFH projects, as is the case with other Federal housing programs.

*Topic:* Several comments addressed Agency concurrence with lease agreements. One commenter suggested the use of standard lease agreements by State to reduce the attorney certification process that is required under the proposed regulation. Other commenters questioned the process of approval of lease modifications. One commenter believed that the Agency's role should be expanded from just a "concurrence" role. One commenter urged that the Office of General Counsel or other qualified Agency staff be involved in lease reviews.

*Response:* The Agency has amended § 3560.156(a) of the interim final rule to state that the Agency must approve all leases. The borrower's attorney is responsible for ensuring that the lease complies with all applicable State and local laws. This should not be unduly burdensome, as most standard leases are in compliance with these laws.

*Topic:* One commenter expressed opposition to the provision in the proposed regulation that allows borrowers with projects receiving section 8 project-based assistance to use the HUD model lease, because tenant rights and regulations are significantly different between the two programs.

*Response:* The Agency appreciates this comment and has revised the language in § 3560.156(e) to clarify that the HUD lease provisions will prevail unless they conflict with the requirements of § 3560.156. The revision also specifies that in the event of an overlap or conflict between the requirements, the provisions most favorable to the tenant will apply.

*Topic:* One commenter expressed concern about the way that the requirements in § 3560.156(d)(5) have been revised. The commenter believed that the new wording could lead to borrowers having to notify a tenant of their intent to bring suit as opposed to notifying them that a suit has been filed.

*Response:* The Agency thanks the commenter for raising this issue. The Agency has revised this section to specify lease clauses stating that the borrower may institute a lawsuit without providing advance notification to the tenant are prohibited.

*Topic:* Commenters stated that the Agency's requirement to provide leases, Notices of Adverse Action, and other

important documents in English as well as other languages when the area contains a concentration of non-English speakers is burdensome from both an administrative and financial standpoint.

*Response:* The Agency acknowledges the commenters' concerns, but has made no changes to the applicable sections of subpart D. The requirements concerning limited English proficiency of applicants and tenants are civil rights issues and are covered under § 3560.2(b) of the interim final rule.

*Topic:* One commenter acknowledged that the proposed regulation includes language not found in the current rule that "borrowers must execute their Agency approved lease with each tenant household \* \* \*". The commenter believed that borrowers should be required to offer the same lease to all households in a project or a locality.

*Response:* The Agency acknowledges the comment. Each household is required in § 3560.156 of the interim final rule to have an executed lease on file and borrowers are required to offer an Agency approved lease to tenants.

*Topic:* Multiple comments addressed that the proposed regulation adds the requirement that leases contain the street address of the management agent to which tenants may direct complaints. Commenters thought that this meant a management agent with authority to address the complaint.

*Response:* The Agency acknowledges the above comment but considers the sentence as written to be sufficiently clear. Therefore, the Agency has made no change to this language.

*Topic:* One commenter did not understand § 3560.156(c)(4) of the proposed rule. The commenter supported the new requirement that leases for rental units that receive rental assistance include a clause that specifies that the tenant's contribution to rent will not increase if rental assistance is terminated due to actions by the borrower. The commenter did not understand the use of the term "other than Federal assistance."

*Response:* The Agency appreciates the commenter's support for the addition of this clause. The term "other than Federal assistance" has been deleted from 3560.156(c)(3) of the interim final rule. (The reference to § 3560.156(c)(4) of the proposed rule was changed and is now § 3560.156(c)(3) of the interim final rule.)

*Topic:* One commenter asserted that leases must state that the housing project is subject to title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, and the ADA. While the current regulation (7

CFR part 1930, subpart C), in addition to identifying the Federal antidiscrimination laws that apply to the housing project, describes the appropriate complaint procedure under those laws, the commenter believed that the complaint information is omitted from the proposed regulation and should be included.

*Response:* The Agency appreciates the commenter's suggestion. The information on applicable civil rights related laws is included in § 3560.156(c)(6). The complaint procedure is described in § 3560.160.

*Topic:* One commenter believed that both the proposed regulation and handbooks should explicitly prohibit lease clauses that would limit occupancy by persons with disabilities.

*Response:* The Agency acknowledges the commenter's concern; however, it is against all applicable Federal civil rights laws to prohibit occupancy by persons with disabilities. The Agency feels that this information does not need to be restated in § 3560.156(d).

*Topic:* One commenter suggested that the Agency provide something similar to the Form RD 1910-11, Applicant Certification Federal Collection Policies for Consumer or Commercial Debts, to tenants at the time that they apply for assistance, because such a form describes actions that may occur to protect the interests of the government.

*Response:* The Agency has not imposed this additional requirement, as the certifications on the forms that tenants complete when they apply for assistance provide the government with authority to collect unauthorized rental assistance.

*Topic:* Several comments were received regarding the Agency's policies on calculating applicant/tenant income and assets. The majority of commenters on this subpart supported the Agency and stated that by using the HUD definitions of annual income, adjusted income, and net assets found in 24 CFR part 5, the Agency will reduce burden on owners and managers who might otherwise be required to use different criteria for calculating income and assets for various Federal programs. Other commenters asked for a comparison between the current practice and the proposed practice to illustrate how the change would affect individuals.

*Response:* The Agency appreciates the commenters' support. The Agency will consider providing some comparison examples for internal Agency procedures.

*Topic:* A commenter suggested that chapter 5 of the HUD Handbook 4350.3, sections 1 and 2, provide considerable

guidance on determining annual income, adjusted income, and net assets. The commenter thought that RHS should include similar provisions in its handbooks or, at the very least, refer borrowers and tenants to this HUD Handbook when questions arise concerning these matters.

*Response:* The Agency appreciates the commenter's suggestion. Because the information from this HUD Handbook is procedural, the Agency will be using similar information on determining annual income, adjusted income, and net assets in Agency internal guidance about program procedures.

*Topic:* Comments were also received on the Agency's policy toward criminal activity and drug use. Several commenters asked that § 3560.154(j) reference 24 CFR part 5.

*Response:* The Agency has modified this section to include this reference.

*Topic:* Other commenters stated that the Agency's policy to not allow the lessee or other adult members occupying the unit who commit a drug violation to enter the premises unless the individual agrees not to commit a drug violation in the future, participates in a counseling or recovery program, or has completed such a program is too lax. These commenters recommended that the Agency employ HUD's one-strike policy.

*Response:* The Agency thanks the commenters for their recommendations; however, the Agency disagrees with the commenter's view that the above-stated policy established in § 3560.156(c) of the interim final rule is too lax. It provides the borrower with the authority to take specific actions to limit the access of such persons and ultimately terminate tenancy if further drug-related violations are committed.

*Topic:* One commenter suggested that § 3560.159(a)(1) should include evidence of minor infractions such as drug paraphernalia.

*Response:* The Agency appreciates the commenter's suggestion. The Agency believes the borrower can include this in occupancy rules or lease provisions without Agency direction.

*Topic:* With regard to § 3560.159(a)(1) and (a)(2), one commenter believed that the regulation should include an innocent tenant defense for material noncompliance cases.

*Response:* The Agency appreciates the commenter's concern. However, the lease termination is based on the terms of the lease, and any member of the household who signs the lease becomes subject to the terms of the lease.

*Topic:* Several commenters stated that the Agency's requirements for occupancy rules described in § 3560.157

should include guidance on how to determine who will remain in the unit and/or receive the rental assistance in the event of a family breakup, particularly in the event of domestic abuse.

*Response:* The Agency appreciates this comment. Households that add or lose any member are required to recertify their income in order to establish eligibility and/or rental assistance levels. This can be found in the interim final regulation at § 3560.158(d).

*Topic:* With regard to § 3560.154(d) and (h), a commenter indicated that the proposed regulation requires the borrower to base decisions related to the approval or rejection of the application on selection criteria contained in the Agency-approved management plan. The commenter believed, however, that the regulation gives insufficient guidance on the development of those selection criteria. The commenter recommended that language be included in this section providing that the borrower give "due consideration to mitigating factors" that might have led to a history of poor credit, and/or employment or housing problems.

*Response:* The Agency appreciates the commenter's concerns. The interim final rule at § 3560.102 (b) requires that the borrower describe his applicant eligibility and selection criteria in the property's management plan, which is reviewed by the Agency.

*Topic:* Several comments focused on the threshold for interim recertifications. These commenters stated that the proposed rule requires a tenant income recertification "whenever a change in household status results in a net tenant contribution change that is greater than \$25 per month." These commenters felt that tenants cannot be expected to understand how a change in their household income will result in a \$25 change in their rent.

*Response:* The Agency reviewed this threshold and has modified § 3560.152(e) to state that an interim recertification is required when a household's monthly income changes by \$100 or more per month. In an effort to achieve a more realistic threshold, the Agency evaluated HUD's requirement for recertification and took into further consideration the generally lower incomes of tenants in Agency-financed properties. The overwhelming majority of tenants have annual incomes under \$10,000 (or about \$800 a month) and turnover at Agency-financed properties does not result in a substantive change in the tenant income profile. The Agency determined that a \$100 per month change (half of HUD's \$200

amount) is substantial enough to trigger a recertification but not common enough to create an undue burden on either the tenant or borrower in terms of documentation and follow-up. The Agency further established that a tenant may request a recertification when household income changes by at least \$50 per month.

*Topic:* One commenter recommended that recertification take place every 2 years rather than every year.

*Response:* The Agency has made no change because the requirement to recertify tenant incomes annually is statutory (see 42 U.S.C. 1490a section 521(a)(2)(B)).

*Topic:* Several commenters addressed § 3560.156(c)(1)(ii) of the proposed rule. One commenter recommended that the proposed rule require residents to obtain advance approval of any increase in household members. Another commenter suggests that, in general, the Agency should consider eliminating recertification when the only change in a household is the addition of a minor child (without any increase in income).

*Response:* The Agency acknowledges the commenters' concerns but has made no change. The Agency does not have the authority to require tenants to obtain preapproval of increases in household members, only to require reporting of these changes. The Agency does not mandate that an interim recertification be completed when a minor child is added to the household unless the household's income will increase as a result.

*Topic:* With regard to tenant certification and verification, a commenter cited that the proposed regulation, unlike the rule that it replaces, fails to set forth any timeframe or deadline for a borrower to process an updated or interim tenant certification.

*Response:* The Agency appreciates the commenter's concern. The timeframe requirement can be found at § 3560.152(e)(2)(iii) of the interim final rule.

*Topic:* Several comments were received regarding policies on the occupancy of accessible units. Several commenters said that § 3560.158(d)(3)(ii) should be modified to say that if an applicant with a need for a unit with accessibility features applies for housing at a project and the unit is occupied by an ineligible family, the family should only be required to move when another suitable unit is available in the project. Some commenters said that the 30-day notification to move needs to be clarified, specifically, those moving can only be given the notification when another nonaccessible unit becomes

available, since it is not the intent to displace a tenant totally. The commenter believed that it would be difficult to rent such units if tenants could be forced to move from the complex on 30 days notice at any time.

*Response:* The Agency thanks the commenters for these recommendations and has modified this section to address the commenters' concerns. Tenants in units with accessibility features will not be required to vacate these units until another appropriate size unit without accessibility features becomes available in the project. The Agency does not intend to displace in-place tenants, but to move them to accommodate the needs of persons with disabilities.

*Topic:* One commenter asked whether a tenant would be considered overhoused if they were disabled and needed an extra room for apparatus related to their disability.

*Response:* A tenant who is disabled will not be considered overhoused if the tenant needs an additional room for an apparatus related to the tenant's disability or a live-in aide.

*Topic:* The Agency heard from several commenters on its policies for allowing surviving family members to remain in units for which they are ineligible after the eligible household member dies. Several commenters recommended that § 3560.158(d) allow a surviving member in this instance to remain in the unit, even if an eligible applicant or tenant is available to occupy that unit, unless another suitable unit becomes available in the project.

*Response:* The Agency has modified § 3560.158(d) of the interim final rule, which deals with surviving family members and establishes timeframes in which surviving members must move to a suitably sized unit when one becomes available.

*Topic:* Several commenters stated that mixed housing projects should not be allowed because designating certain units for occupancy by families and others for occupancy by elderly households constitutes segregation and is in violation of title VIII of the Civil Rights Act of 1968.

*Response:* The Agency thanks the commenters for their recommendation. The interim final rule at § 3560.151 has been revised to clarify that mixed projects are no longer eligible for Agency financing under the multi-family housing program.

*Topic:* The Agency received several comments regarding pets and service animals. The most frequent comment was that the definition of reasonable pet rules must be clarified. One commenter noted that the proposed regulation should contain a further discussion of

factors to consider in the development of pet rules and a list of prohibited clauses, and that borrowers of operational projects consult with tenants when revising pet rules and document how that consultation process was conducted.

*Response:* The Agency appreciates the commenters' concerns. Internal Agency procedures will provide further guidance on the development of pet rules.

*Topic:* Several comments addressed the issue of guests. One commenter suggested that the trespass provision of § 3560.156(c)(12) of the proposed rule may violate State laws and Constitutional rights to association. Other commenters suggested that the proposed rule should specify exactly when a guest will be considered a member of the household so that these criteria are applied equally, fairly, and consistently at all RRH projects.

*Response:* The Agency acknowledges the commenters' concerns, but has made no change because the lease requirements established in § 3560.156(c)(12) of the proposed rule are statutory. Further, § 3560.157(b)(10) establishes the borrower's responsibility to establish the terms under which a person staying in the unit is no longer considered a guest and becomes a member of the household as part of the property's occupancy rules. The Agency has not provided further detail because the appropriate definition will vary depending on local circumstances and in some cases local law. The Agency believes that this policy is most appropriately set by the borrower and then applied consistently within a property. The interim final rule provides guidance on situations in which there is a conflict between Federal and State or local laws. Specifically, if any lease provision is in violation of State or local law, the lease may be modified to the extent needed to comply with the law.

*Topic:* Multiple commenters addressed § 3560.156(c)(6) and the requirement that leases will state that the housing will be subject to the ADA. However, the commenters pointed out that if there is no public space, this law would not be applicable.

*Response:* The Agency thanks the commenters for raising this issue and has removed the reference to the ADA from § 3560.156(c)(6) of the interim final rule.

*Topic:* One commenter expressed concern about the requirement in § 3560.156(c)(4) of the proposed rule that leases must specify that no change in the resident contribution will occur due to loan prepayment. The

commenter believed this has the effect of extending use restrictions for undefined periods, which is inappropriate and inconsistent where the Agency has determined that prepayment is acceptable or where it has been judged the owner's contract right.

*Response:* Tenant contributions as a result of prepayment are covered under subpart N—Housing Preservation in the interim final rule. Reference to subpart N is made at § 3560.154(c) of the interim final rule.

*Topic:* Several comments were received on including office hours in the occupancy rules and leases. Commenters believe the office hours should be removed from the occupancy rules; including this in the occupancy rules would require unnecessary changes.

*Response:* The Agency has made no change because § 3560.157(b)(7) states that the office hours must be posted at the property and included in the project's occupancy policies. While the occupancy policies are to be attached to each tenant's lease, the Agency believes that it is not too cumbersome to provide a blanket amendment to each tenant's lease in which the new office hours are listed.

*Topic:* One commenter addressed § 3560.157(c), which requires that 30 days notice be given to residents upon a change in the occupancy rules, despite the fact that the preceding paragraph requires the ongoing and permanent posting of the current occupancy rules. The commenter believed that this paragraph serves no useful purpose since the occupancy provisions that exist at the time of signing the lease are the only rules that apply to any given tenant.

*Response:* The Agency wishes to clarify this matter. The occupancy rules are an attachment to the lease, not the lease itself. The borrower may not change the lease, but may change the occupancy rules, upon written notification to all tenants.

*Topic:* One commenter noted that the current regulation provides examples of unreasonable restrictions on the use of community rooms by tenants and tenant organizations, but the proposed regulations omit these examples. The commenter thought that they should be included.

*Response:* In § 3560.157(b)(6), the interim final rule states that the occupancy rules must address housing services and facilities available to tenants and members. The Agency will incorporate this information into its internal Agency procedures. Some examples of unreasonable restrictions

may include occupancy rules requiring management representatives to be present in order to use community rooms, barring tenant or cooperative organizational meetings from using the rooms, or requiring management representatives to be present at any resident organizational meeting held in community rooms.

*Topic:* One commenter suggested that the Agency remove the words "beyond agreed to grace period" from § 3560.159(a)(1)(ii).

*Response:* The Agency has made this change to § 3560.159(a)(1)(ii) of the interim final rule.

#### **Subpart E—Rents**

*Topic:* The Agency received numerous comments addressed to this subpart about the CRCU limitation. While these comments are discussed here, the Agency notes that CRCU is covered in a number of subparts throughout the rule, including subparts A, B, G, I, and N. Some supported the concept, while many expressed significant reservations. Those that did not support the concept argued either that market forces already achieve the objective sought by the Agency, or that the concept places the properties in jeopardy by limiting the resources available to them. In particular, they noted the potential danger to troubled housing, new construction, and Farm Labor Housing. They asked that the concept be piloted before being used broadly. Others asked that the Agency specifically cite its exception authority.

Commenters cited the critical importance of clearly defining terms such as "conventional," "comparable," and "reasonable costs." Many commenters noted the difficulty of establishing comparable rents in rural areas. They noted that comparable units must be similar in terms of size and age, within the same market (not geographic) area. Several commenters stressed that the cost of developing new units may not be reflected in local market rate units. Commenters also noted that section 515 projects have operational costs that make them difficult to compare to conventional units such as tenant grievance procedures and reserve requirements. Commenters also fear that the CRCU may serve as a disincentive for new owners to take on troubled properties and may make it difficult to work with other funding sources. They asked that there be sufficient flexibility in the definition to facilitate transfers, rehabilitation, and new units and to work with other leveraging sources. Finally, one commenter stated that the CRCU limitation should not apply to public housing authorities.

*Response:* The Agency recognizes and acknowledges the commenters' concerns. CRCU applies to loan applications, servicing actions, and preservation actions, not to annual budget reviews and requests for rent changes. As noted in the preamble to the proposed rule, the Agency has incorporated this policy into the multi-family regulations to improve the long-term viability of the multi-family properties in the program, limit future costs of rental assistance, and reduce the risk of defaults. The Agency emphasizes that the interim final rule provides RHS with explicit authority to grant exceptions that allow rents that exceed CRCU under certain circumstances, such as when allowing these rents would preserve a valuable affordable housing resource. This flexibility addresses a number of the commenters' concerns. Section 3560.205(f)(4) was deleted in the interim final rule in order to address any confusion.

*Topic:* Numerous comments were received on the Agency's policies on rent payment grace periods and late fees. Commenters stated that rent should be due by the fifth day of the month and that late fees should be increased. They stated that the grace periods and fees in the proposed rule are not industry standard and do not provide sufficient incentive to tenants to pay on time. They also noted that they are not consistent with HUD rules and asked for guidance about what to do in projects with HUD funding.

*Response:* While the Agency understands that conventional properties have a stricter definition of late rent payments and charge higher late fees, it has made no change to § 3560.209. Many tenants of sections 514, 515, and 516 properties receive their income from Government agencies by mail. Allowing a 10-day grace period helps to ensure that tenants are not penalized when their checks are not received on time and mirrors the borrower's grace period for submitting mortgage payments to the Agency. Likewise, increasing late fees would be prohibitive to many tenants living in Agency-financed properties. For properties with multiple sources of financing, the strictest rules always apply.

*Topic:* Some commenters addressed the use and refunding of security deposits. Several of these commenters remarked that the proposed rule allows for payment plans for security deposits but offers no parameters for these plans. Other commenters said that "routine turnover expenses" and other items that may not be covered by a tenant's security deposit should be more clearly

defined or that the Agency defer to State laws on this issue. They also asked for language to clarify the policy on pets versus companion animals.

*Response:* The Agency acknowledges these concerns and notes that the parameters for security deposit payment plans are described in internal Agency procedures. The Agency has revised § 3560.204(d)(1) in the interim final rule to substitute "routine turnover expenses" with "expenses due for addressing normal wear and tear." "Normal wear and tear" is a term that is commonly used and understood by the property management industry. The Agency has also revised the interim final rule to distinguish between pets and companion animals.

*Topic:* Several comments were received on the budget-based rent approach described in the proposed regulation. Several commenters said that there should be standard rent increase allowances, such as occupancy cost adjustment factor (OCAF) or cost-of-living increases that are reviewed every three years but are automatic during the interim years. They also noted that project rents must work with rent standards established by other funding sources (typically the 30 percent of Area Median Income (AMI)). Several other commenters were concerned that the budget-based rent approach would be undermined by CRCU, which would impose an arbitrary cap. Still others asked for clarification on the four definitions provided in § 3650.202(c), specifically the mention of LIHTC rents. Finally, commenters asked how rents would be tested once established.

*Response:* Regarding the budget-based rent approach, see the Agency's response in the description of comments received on subpart G (Financial Management). The Agency has clarified in the preamble to the interim final rule that the comparison to CRCU will not be applied during reviews of project budgets, only to new projects, projects requesting servicing actions, and preservation activities. The Agency has listed CRCU as a standard in the rule in the circumstances when the Agency will use it as a standard. The Agency wants to clarify that CRCU is not listed as a standard in § 3650.303 of the interim final rule because it will not be used during Agency reviews of annual project budgets. With regard to the comments on the four definitions provided in § 3650.202(c), the rents listed in § 3650.202(c) are now defined in subpart A of the interim final rule. The Agency also deleted § 3560.205(f)(4) in the interim final rule.

*Topic:* Several commenters said that the annual review of utility allowances is too time-consuming and should not be required.

*Response:* Because utility costs can change notably from year to year, the Agency, and its interim final rule, requires annual review of utility allowances as a necessary part of the budgeting process. Just like the annual tenant income recertification, this annual review helps to ensure that the amount that tenants pay for shelter cost is not greater than specified by the program, and helps ensure that rental assistance usage reflects the utility costs that tenants actually face.

*Topic:* Several commenters requested that rather than having all rent changes for all projects go into effect at the beginning of the project's fiscal year, these should be permitted at any other time. They noted that by allowing new rents to take effect over several months, borrowers could submit rent changes and tenant certifications simultaneously, saving time for the Agency, the borrower, and the tenant.

*Response:* The Agency appreciates these comments, but no change has been made because the rent changes are requested as part of the annual budget that must be submitted for the fiscal year. However, it should be noted that § 3560.205(c) of the interim final rule states that the Agency will accept borrower requests for rent changes anytime during the year if the property is financially distressed due to circumstances beyond the borrower's control.

*Topic:* Several commenters asked that the Agency allow projects to keep section 8 overage as project revenue to address necessary project repairs. They noted that the Agency is willing to offer interest credit of 1 percent rents regardless of tenant subsidy and therefore should be willing to consider letting the project keep the section 8 overage. Commenters also asked that overage paid by the tenant be kept by the project.

*Response:* In such instances of overage, the borrower's interest credit will be reduced. Further, if a borrower is collecting significant overage from tenants, project rents should be reevaluated.

*Topic:* One commenter asked that the proposed rule be revised to address the circumstance of a security officer occupying a unit for the good of the property.

*Response:* The Agency's interim final rule does not address this issue as it is currently dealt with on a case-by-case basis.

*Topic:* One commenter asked that the paragraph on funds contributed to reduce rents clarify that this does not mean borrower contributions or rehabilitation loans.

*Response:* The Agency appreciates the comment and notes that the language in the proposed rule was not intended to mean borrower contributions or rehabilitation loans. The Agency added a sentence to § 3560.202(e) of the interim final rule to clarify that funds from borrower contributions or rehabilitation loans will not be counted towards reducing rents.

*Topic:* One commenter welcomed the move toward conversion to Plan II, as this will reduce the cost of operating section 515 projects.

*Response:* The Agency appreciates the commenter for this support.

*Topic:* Several commenters remarked that the Agency's approach to reviewing HUD section 8 subsidized budgets is only appropriate when HUD is providing less than 100 percent of the tenant subsidy. They suggested that when HUD is providing 100 percent of the tenant subsidy, the Agency should allow the project to charge the rents HUD is willing to subsidize.

*Response:* The Agency acknowledges the comment but no change has been made to the interim final rule because the Agency seeks to ensure that properties in the program do not receive excessive subsidy. HUD has issued guidance regarding reviewing HUD section 8/515 subsidized budgets. The information is included in chapter 14, "RHS section 515/8," of HUD document, "Section 8 Renewal Policy—Guidance for the Renewal of Project-Based Section 8 Contracts." This document is available on the HUD Web site at: <http://www.hud.gov/offices/hsg/mfh/exp/guide/s8renew.pdf>.

*Topic:* Commenters had issues with the provisions for rent payment during eviction proceedings. They noted that rent cannot be accepted when eviction proceedings are underway. Further, they questioned why rental assistance and interest credits are suspended, as this can be detrimental to the property. One commenter added that while tenants under eviction proceedings are charged the note rent, they do not always pay it and that borrowers should only be responsible for the note rent if they actually receive it. Finally, one commenter stressed the need to protect tenants by ensuring that a failure to recertify was truly a willful act on the part of the tenant and that the tenant received adequate notice about recertification.

*Response:* The Agency acknowledges these comments and has revised its

language in § 3560.208(a) of the interim final rule to require borrowers to put any rent received during eviction proceedings into escrow and has removed language suspending rental assistance and interest credits. The Agency believes that the current language adequately protects tenants as it requires sufficient notice.

*Topic:* Comments varied regarding the extension of time to submit the recertification. One commenter said the extension would be helpful because obtaining signatures from agricultural workers and immigrants on extended family trips can be difficult. Another commenter agreed that the additional 10 days for certifications and recertifications would be helpful. However, one commenter disagreed with the extension.

*Response:* The Agency appreciates these comments. The majority of the comments agreed with the proposed rule, therefore, no changes were made for the interim final rule.

*Topic:* One commenter suggested that utility allowances be calculated only once every three years, with adjustments to the rate only once a year.

*Response:* The Agency appreciates the comment but did not make this change. In § 3560.202(d) of the interim final rule, the Agency notes that borrowers must review utility allowances annually, adjust for accuracy, and submit any utility allowance changes to the Agency for approval. Even if there are no changes, the borrower must notify the Agency that no changes were made. This annual review is necessary because utility allowances are integral to a project's budget and budgets must be submitted annually in accordance with statute 42 U.S.C. 1490(a)(2)(B).

#### Subpart F—Rental Subsidies

*Topic:* Several commenters addressed the Agency's requirement to submit information to the Agency electronically. Some commenters expressed concern about submitting certification and recertification information, stating that this requirement is unfair to "mom and pop" ownership entities that will resist submitting the information electronically. Others stated that older properties in the portfolio should be exempt from this requirement. Conversely, several commenters urged that the Agency encourage or require the use of Industry Interface, for example, when borrowers submit their monthly requests for rental assistance payments, as under § 3560.256, and for the purpose of assigning rental assistance, as under § 3560.257.

*Response:* The Agency is requiring electronic submission in order to expedite the gathering of requisite data. Section 3560.102(i) establishes the submission requirements for properties with eight or more units. The Agency has been upgrading their automation processes to provide better flexibility for borrowers to submit data electronically to the Agency. The upgraded system, Management Interactive Network Connection (MINC), allows for borrowers to use software purchased from vendors or input data directly into the MINC Web site. For more information, access the MINC Web site at <https://usdaminc.sc.egov.usda.gov>.

*Topic:* One commenter asked if a tenant that receives a subsidy under a HUD program is prevented from giving up the subsidy to qualify for rental assistance under RHS.

*Response:* The Agency notes that a tenant receiving a HUD subsidy is only required to give up the subsidy when a rental assistance unit is available.

*Topic:* Several comments were received in which the commenter stated that the priorities for assigning rental assistance shown in § 3560.253(b) should be changed or removed.

*Response:* The Agency acknowledges that these priorities were confusing and has deleted this paragraph in its interim final rule.

*Topic:* Several commenters addressed eligibility issues under § 3560.254. One commenter addressed the requirements for eligible units, stating that the current requirements to meet § 3560.103 were impossible to achieve and that alternative language could include "Borrowers may not request rental assistance for rental units that are not habitable." Another commenter suggested that the Agency add language to this section that would terminate rental assistance for borrowers found in noncompliance with Agency requirements, "as a means for expediting repairs and corrective actions."

*Response:* The Agency has addressed this topic in the revisions to subpart C. The Agency has modified the requirements in § 3560.103 to recognize borrower progress in correcting physical deficiencies. If a borrower is correcting physical deficiencies within a reasonable period of time, the borrower will not be found out of compliance.

*Topic:* One commenter wrote that "the change to require interim tenant recertifications only when the change in rent would be \$25 or more is an improvement."

*Response:* The Agency appreciates the commenter's support for the change and has made a change in this policy in the

interim final rule to follow the structure used by HUD for recertifications. In the interim final rule, interim recertifications are required only when a household's monthly income increases by \$100 or more per month.

*Topic:* Other comments addressing § 3560.254 discussed household eligibility. One commenter suggested that compliance with occupancy rules be clarified so that households that are under- or overhoused due to a lack of appropriately sized units do not lose their eligibility; they should retain their rental assistance but be required to move when an appropriately-sized unit becomes available. Another commenter suggested that the requirement for having a signed, unexpired tenant certification form on file be clarified so that households retain their eligibility if the lack of such a form is not the household's fault.

*Response:* The Agency notes that subpart D clarifies that under- and overhoused tenants will retain their rental assistance and be required to move when a unit becomes available. For situations in which a tenant does not have a signed, unexpired certification form on file, the Agency has not modified this rule, but recognizes that individual circumstances should be considered and that no tenant should be unfairly penalized.

*Topic:* Several commenters expressed dismay at the Agency's citizenship requirements. Commenters said that the Agency should not be in the business of immigration status. More specifically, one commenter questioned whether RHS had an adequate basis to consider an entire household to be eligible based on the citizenship or immigration status of its head of household, and therefore be eligible for assistance only if the head of household is eligible. The commenters believed that one solution would be to follow HUD's approach of prorating assistance to the household based on the eligibility of each individual. If the Agency retains this requirement, another commenter stated that many otherwise eligible farmworker families would no longer be eligible for occupancy in Agency-assisted housing.

*Response:* The Agency acknowledges the commenters' concerns, but no change has been made because the requirement for occupants of sections 514, 515, and 516 housing to be citizens or qualified aliens is statutory.

*Topic:* Another commenter was confused by the head of household citizenship requirement because it implied that non-rental assistance units could be rented to noncitizens/illegal aliens. This person stated that the implication would contradict the

requirement "in § 3560.152 that all household [sic], regardless of rental assistance status, qualify under the citizen/alien definition in § 3560.11."

*Response:* The Agency notes that the head of household citizenship requirement does not imply that non-rental assistance units could be rented to noncitizens/illegal aliens. The requirement that all households, regardless of rental assistance status, must qualify under the citizen/alien definition is statutory.

*Topic:* One commenter suggested that the Agency coordinate with the Department of Homeland Security (DHS) as HUD has, incorporating appendix 2 to the HUD Handbook 4350.3, which is a copy of the User Manual created by U.S Citizenship and Immigration Service (USCIS) in 2000 for the Systematic Alien Verification Entitlements (SAVE) Program. References to USCIS should also be replaced with references to DHS.

*Response:* The Agency recognizes that the correct reference is DHS. However, the Agency does not feel this comment lends itself to being incorporated in this rule. Nevertheless, the commenter's suggestion is incorporated into the Agency's guidance about program procedures.

*Topic:* Several commenters expressed their approval of the new requirement that allows borrowers to request rental assistance by checking a box on the budget form.

*Response:* The Agency thanks the commenters for their support.

*Topic:* One commenter questioned the Agency's automatic renewal of rental assistance agreements at the existing unit number because the policy does not account for changes in the number of units or the amount of rental assistance being received.

*Response:* The Agency recognizes that changes occur. When borrowers need rental assistance for more units, they can apply for additional units. When borrowers require rental assistance for fewer units, the Agency will transfer the rental assistance to properties with greater need. Consequently, the Agency does not feel a change to this rule is necessary.

*Topic:* Two commenters disagreed with the Agency's requirement that the borrower notify tenants of a subsidy loss when the Agency does not have funding available to renew the borrower's rental assistance contract.

*Response:* The Agency has decided to retain the requirement that the borrower notify the tenant because the borrower is in a landlord-tenant relationship with the tenant, and the loss of rental

assistance may affect the terms of the lease.

*Topic:* Several commenters said that the borrower should have the option of paying utility allowances to the utility companies in individually metered projects. Another suggested that the Agency allow the issuance of a joint check made payable to the tenant and the utility company to prevent fraud and abuse and to allow the payment to be applied directly to the tenant's utility bill.

*Response:* While the Agency acknowledges the commenters' concerns, it does not have the capacity at present to pay some utility allowances directly to the utility companies. Implementing this suggestion would cause an undue administrative burden to the Agency. Currently, management companies may issue a joint check payable to the tenant and the utility company.

*Topic:* One commenter suggested that the Agency clarify § 3560.256 to prevent borrowers from holding households financially responsible when the Agency adjusts rental assistance payments.

*Response:* The Agency notes that this issue is clarified in the public comments and Agency responses addressing subpart O.

*Topic:* The Agency received several comments urging RHS to prorate rental assistance based on the tenant's move-in date.

*Response:* The Agency acknowledges that for units where a tenant moves in during the middle of the month and the tenant is eligible for rental assistance, either the property or the tenant covers the difference. However, the Agency has made no change to the interim final rule because it does not currently have the information system capability to allow rental assistance to be prorated.

*Topic:* Other commenters questioned the idea that residents must be in good standing to receive rental assistance. The commenters' believed that tenants should be able to be somewhat delinquent and able to pay back rent through a payment plan; if tenants could afford to pay their rents without hardship, they would not be eligible for rental assistance in the first place.

*Response:* The Agency appreciates the comment; however, no changes have been made to this subpart. The Agency allows borrowers to establish policies on rent charges under § 3560.157(b)(2) and encourages borrowers to structure these policies to permit workout or payment plans for tenants who encounter payment difficulties due to circumstances beyond their control. Tenants who are following a payment

plan that is consistent with such a policy and acceptable to the borrower would be in adequate standing to receive rental assistance. However, the Agency wants to emphasize that such policies do not relieve tenants of their responsibility for timely rental payments.

*Topic:* Several commenters addressed the requirements for assigning rental assistance in § 3560.257. Commenters indicated that requirements generally needed to be more flexible and that, in particular, documenting the percentages occupied by low-income households was burdensome.

*Response:* The Agency appreciates the commenters' desire to have more flexibility, but its first responsibility is to the tenants. By assigning priorities and targets, the Agency has tried to use its available rental assistance to best serve the tenants with the greatest need. Information about the percentage of low-income households is necessary to help the Agency manage its rental assistance resources most effectively. Consequently, neither of these suggestions are being adopted in this rule.

*Topic:* Two commenters agreed that identifying the term of rental assistance agreements or having no term was problematic. One person nevertheless suggested that the term could be "when the funds obligated for the units are expended or 5 years, whichever comes first."

*Response:* The Agency appreciates the comment; however, the term of the agreements have traditionally been established in the appropriation language each fiscal year, and can change. Therefore, the Agency has not specified the term of the agreements in the interim final rule.

*Topic:* One commenter stated his support of the "change to allow a lease clause stating that a tenant's rent will not increase when rental assistance is terminated by actions of the borrower/owner."

*Response:* The Agency thanks the commenter for supporting this provision; this lease clause is addressed in subpart D.

*Topic:* Several commenters addressed § 3560.259 on the transfer of rental assistance, with most concerns addressing the effect of the transfer on the property. For example, two commenters recommended that unused rental assistance remains equal to 5 percent of the total units to avoid financial problems that occur if the property ends up with less than 95 percent occupancy the following year. Other commenters addressed the conditions under which rental

assistance might be lost and thought clarification in the regulation is needed for conditions such as transfer of rental assistance due to unit damage during a disaster, the inability to get an ineligible tenant evicted, turnover in separate units over 4 months, or units for which tenant-based section 8 has been accepted and no rental assistance would be used.

*Response:* The Agency appreciates the comments addressing the various conditions that could effect and be affected by the transfer of rental assistance. The Agency believes that most issues should be resolved by the 6-month timeframe that occurs before the Agency assesses whether to transfer rental assistance. For all situations, particularly those brought about by disasters or by eviction, the Agency has exception authority under § 3560.8 of the interim final rule. For clarification, the timeframe for transferring rental assistance refers to one unit, not to multiple units several months in a row.

*Topic:* Other comments on the transfer of rental assistance focused on the borrower's role in transferring rental assistance. Regarding the borrower, commenters urged that the regulation expressly allows borrowers to transfer rental assistance from one project to another or to accommodate the transfer of rental assistance among projects under a common general partner.

*Response:* The Agency acknowledges the commenters' suggestion; however, RHS must consider the needs of the larger portfolio and tenant population in making decisions about the allocation or transfer of rental assistance. For this reason, the Agency has made no change, and it remains the Agency's decision regarding where to transfer rental assistance.

*Topic:* Other comments on the transfer of rental assistance focused on the effect on the household. One commenter recommended that households in a project who did not receive rental assistance be notified of the transfer of the rental assistance prior to its approval. Another commenter pointed out that households that were over-income are allowed to pay the "overage," and suggested "leases be allowed to "non-renew" at the annual recertification date for any "overage tenant" whose continued occupancy prevents reassignment of rental assistance."

*Response:* The Agency notes that the regulation already protects the interests of non-rental assistance tenants in the property and has made no changes to the interim final rule. Prior to transferring rental assistance, the Agency conducts a review to determine

if the property has other eligible households that qualify for rental assistance. Also, borrowers who lose rental assistance through transfers can apply for new rental assistance units when their property reflects a need. The Agency considered the comment regarding "overage." Tenants paying overage are eligible to reside in Agency financed housing properties and should not be forced out of their units when they are still income eligible. The Agency's housing is available to very low-, low- and moderate-income tenants in rural areas.

*Topic:* The Agency received numerous comments on § 3560.259 regarding the Agency's timeframe for transferring rental assistance. Several commenters contended that requiring the transfer of unused rental assistance after 4 months is not sufficient for several reasons, including the seasonal nature of farm work and the recreational industry and the time it takes to repair units after disasters. Several commenters stated that the Agency should continue to transfer unused rental assistance after 12 months. However, one commenter agreed that rental assistance should be transferred if it is unused for 4 months or more to ensure that the assistance goes to those with the greatest need.

*Response:* The Agency appreciates these comments and acknowledges that four months does not give the Agency sufficient time to analyze assistance needs of current tenants. Therefore, the Agency has increased the time period to six months in the interim final rule.

*Topic:* Several comments were received in connection with the Agency's requirement that non-RHS subsidy contracts cannot be for less than five years. Some commenters said that non-Agency rental assistance should be allowed for any period of time because "some rental assistance is better than none," as one commenter noted. Other commenters said that this requirement is inconsistent with those of other funding sources.

*Response:* The Agency acknowledges the commenters' concerns and has revised § 3560.260(d)(2) in the interim final rule to allow for subsidy agreements with non-Agency sources "similar to existing or current Agency rental assistance funding levels." This should make it easier for projects with Agency financing to obtain rental assistance from other sources.

*Topic:* Two commenters provided the following comment: "Projects with HUD certificates (project based) have often received a minimal or no mortgage rate interest credit reduction from the Agency, which often realizes a basic

rent equal to HUD established rent. This regulation should allow for use of the HUD established rental rate."

*Response:* The Agency notes that § 3560.207 of the interim final rule addresses this issue.

*Topic:* Two commenters addressed the topic of minimum rents. One commenter expressed disappointment that the regulation did not address zero income tenants and require a minimum rent level. One commenter wrote that zero rents should be prevented (especially in labor housing) and suggested that there be a minimal payment of \$50 or \$100, with exception granted by the Agency.

*Response:* The Agency has considered the suggestion but has decided to retain the language from the proposed rule at this time until it has time to further evaluate this issue.

*Topic:* One commenter suggested that the regulation allow rental assistance to go to higher rent units in LIHTC and tax-exempt bond projects.

*Response:* The Agency has decided not to adopt the comment; because rental assistance is not assigned to a particular unit or rental rate, it is prioritized by the tenant's need. The Agency details its priorities in § 3560.257(a) of the interim final rule.

*Topic:* Two commenters suggested that the Agency allow borrowers flexibility in how they make use of rental assistance to maximize its benefits, particularly when the tenant household income rises and its relative use of rental assistance declines to a nominal amount. In this situation, one commenter stated: "The rental assistance unit is tied up and cannot be reassigned to a more needy very low-income tenant/applicant. This predicament could be alleviated by creating latitude for borrowers to intervene and assume responsibility of the cost of rental assistance to tenants or for the project to offer marketing incentives to near-moderate income tenant (e.g., those using rental assistance at a rate of <\$10 per month)."

*Response:* The Agency believes this comment is permitted under this rule. However, the Agency will need to draft implementing procedures.

*Topic:* One commenter asked for clarification regarding § 3560.257 because that commenter did not understand the issue.

*Response:* In § 3560.257 of the interim final rule, the Agency gives priority to the tenants who most need rental assistance. The issue is further discussed in the Agency's internal guidance about program implementation.

*Topic:* One commenter stated that the changes in the calculation for electronic resubmission of certifications/recertifications were unclear.

*Response:* The Agency believes that the commenter misunderstood the changes; the timeline was changed, but the calculation was not changed. The timeline changes are addressed earlier in this subpart.

#### **Subpart G—Financial Management**

*Topic:* Numerous comments were received on § 3560.308 regarding the requirements for submitting annual financial statements. Several commenters stated that lowering the threshold for requiring a Government Auditing Standards (GAS) audit for projects from 25 units to 16 units would be cost-prohibitive, particularly by raising the costs for projects least prepared to absorb the additional costs. Several commenters attempted to estimate the increase in cost, including the cost to tenants or to taxpayers of subsidizing this increased expense. Additionally, because the number of projects requiring an audit will go up, a commenter stated that this requirement will create an additional burden on Area Offices to review these audits. Other commenters disagreed, stating that the submission requirements for small properties currently do not contain sufficient information to adequately analyze the financial status of the project, and that the additional requirements in the proposed rule are appropriate. Several commenters suggested an agreed upon procedures report for smaller properties that is consistent with generally accepted accounting principles (GAAP) under 42 U.S.C. 1485(z)(1) be required as an alternative to a standard audit. Another commenter suggested using a “verification of review” to achieve the same goals as the audit at lower costs. Another suggested requiring audits every second or third year or forgoing audits on projects that have a good track record of financial integrity as a way of reducing the burden. Another commenter said that audits are only as good as the accountant providing them; since the owner is the one providing the information and paying for the audit, it is doubtful that requiring audits on smaller complexes will bring to light additional fraudulent activities. The commenter went on to say that MFH specialists do not have accounting degrees and are not equipped to quickly recognize fraudulent activities, and that an audit of the project should provide all pertinent information that RHS is interested in that affects Agency-financed projects.

*Response:* As discussed in the preamble to the proposed rule, the Agency implemented the change to address concerns raised by the USDA OIG. The Agency has modified § 3560.308 of the interim final rule in response to the commenters’ concerns, while staying consistent with the actions agreed upon with OIG. OIG requires that annual financial reports are prepared in a way that allows the Agency to get a realistic picture of the property’s financial status and operations. By requiring an Agency approved engagement, the Agency should be able to address OIG concerns and obtain the information necessary to get an accurate picture of the property’s health. In addition, the Agency has substantially modified § 3560.308 in the interim final rule to allow properties with 16 or more units to obtain an Agency approved engagement report. This section also states that properties with fewer than 16 units may obtain a limited-scope engagement. These engagements may be conducted by a CPA or other accounting professional and will cost considerably less than GAS audits, thereby minimizing the financial impact on the properties. The Agency has not adopted the suggestion for procedures reports or verification of reviews because the Agency needs the information that would be provided in an acceptable engagement letter so that it can meet OIG needs. The Agency’s new policy shifts away from standard GAS audits to year-end reports that provide a more detailed picture of each property being managed. To address the issue of additional burden on Area Offices, RHS intends to automate most of the review process, enabling Area Office staff to concentrate on problem cases. One of the major considerations of the Agency in developing this new policy was the financial impact on properties. The limited scope engagement required in § 3560.308 provides the Agency with adequate financial information while not imposing a full audit requirement on smaller properties. The Agency has the option to obtain full audits on randomly-selected properties every two or three years. The Agency notes the concerns about the accountants being selected by the borrowers, but feels that the current rule strikes the best balance between risk, cost, and reliability.

*Topic:* Two commenters suggested raising the number of units triggering the audit threshold from 25 to 33 or 36, rather than lowering it to 16. Another commenter suggested that the cost to projects that had not been subject to the auditing process would be high,

especially to prepare the first audit, as this auditor would want to review data from the beginning of the project, which will increase operating expenses for the most difficult properties to manage. These properties will have to impose rent increases to accommodate the additional expense. Another commenter said that one reason stated for this new requirement is to further monitor IOI transactions, and that the new proposed management certification should provide the Agency with a certain amount of comfort that it is putting borrowers on notice that IOI relationships will be closely monitored. Another commenter said that the list of borrower accounting responsibilities should include a requirement to maintain documentation of the financial benefits where IOI work is used. The dollar amount of fraud at smaller properties would be less than the added expense of trying to catch it. Another commenter said that the proposed rule basically allows projects with less than 16 units to self-certify that their financial reports are accurate; the proposed rule is unclear in that it says the borrower must certify that the “\* \* \* housing meets the performance standards \* \* \*” The commenter went on to say that the rule should be more specific, saying that the borrower must certify that the financial statement report is accurate and that project funds have only been used for authorized purposes and for expenses that are actual, necessary, and reasonable. A commenter said that Agency personnel are currently awaiting the publication of an Agency guide about preparing annual financial statements being developed with the assistance of OIG.

*Response:* The Agency acknowledges the commenters’ concerns. The policy set forth in the proposed rule and the interim final rule—the 16-unit threshold—responds to OIG’s concern that the Agency is not receiving a complete and accurate picture of the financial and operational status of the properties in the Agency’s portfolio. While the Agency’s goal is to receive more targeted information, it recognizes that GAS audits performed by independent CPAs are costly, which is why the Agency has opted to allow annual reports that are tailored to Agency specifications for larger projects and limited scope engagements for smaller projects. The Agency has researched the costs of obtaining these types of financial reports, which are substantially lower than the cost of a GAS audit. The Agency does not think that the cost of such audits will pose an undue financial burden, such as

increased rents, on the properties in its portfolio. With respect to identity-of-interest relationships and their impact on the financial activity at properties, the new management certification will reveal such relationships but the new financial statement requirements outlined in § 3560.308 will provide more financial information regarding these relationships. The new regulation also outlines the performance standards each engagement and limited engagement is required to cover. Agency review of this information will verify the owner's certification. The Agency did not adopt the suggestion regarding maintaining documentation because that documentation must already be retained for audits provided under this rule.

*Topic:* Two commenters said that the Agency should not require an Agency engagement letter, as this would create additional burden on Agency staff and could cause delays in completing the audit if the Agency does not approve the engagement letter in a timely manner. The commenters went on to say that it would be beneficial for the Agency to provide suggested wording in accordance with AICPA. Another commenter said that if the Agency's intention is to distribute the exact verbiage entailed in an engagement letter, it may be beneficial for the Agency to ensure the wording is in accordance with GAS and AICPA standards. The commenter noted that if the prescribed letter was not written in accordance with the above mentioned standards, accounting firms would still need to issue a separate engagement letter to discuss their procedures to be performed in accordance with GAS and AICPA standards. The commenter went on to say that such firms are required to issue an engagement letter detailing the procedures to remain licensed in their profession by peer review standards.

*Response:* The Agency thanks the commenters for raising this issue; however, the commenters seem to have misinterpreted § 3560.308(b). The Agency does not feel that audits in accordance with GAS are sufficient because they would not sufficiently cover IOI compliance issues and do not provide a sufficient sampling for this program. This section states that the borrower must use an Agency approved engagement letter, not that the Agency must approve the engagement. The engagement letter must be approved by the Agency. The Agency will consult with the OIG which regularly consults with AICPA on engagement and audit compliance standards. Therefore the engagement letter should be in alignment with AICPA requirements.

*Topic:* One commenter suggested that § 3560.308(a)(1) should be limited to requiring that engagement letters be compliant with GAS. Another stated that the regulation should specifically state that the audit should be in accordance with GAS. Another commenter said that for projects with less than 16 units where a compilation is required, the MFH Balance Sheet should be submitted. For project with 16 or more units, in lieu of the MFH Balance Sheet, a balance sheet in accordance with GAS should be accepted. Another commenter pointed to chapter 1, section 1.01 of the GAO Government Auditing Standards 2003 Revision issued by the Comptroller General of the United States which states that audits and engagements compiled according to GAS are considered reliable. This commenter also highlighted chapter 1, section 1.02, regarding auditors who use GAS can support Government accountability. Another commenter stated that the idea of not getting audits on all projects creates more opportunity for problems; while this might save a project some money, most owners must have audits prepared for their partners anyway.

*Response:* The Agency acknowledges the commenters' concerns. The Agency does not feel that audits in accordance with GAS are sufficient because they would not sufficiently cover IOI compliance issues and do not provide a sufficient sampling for this program. The Agency has established the engagement standards. A balance sheet is not sufficient to meet OIG requirements. The regulation does not prevent borrowers from obtaining GAS audits, but rather seeks to ensure that the Agency receives detailed financial information tailored to its needs to assist in the Agency's portfolio analysis.

*Topic:* One commenter said that in the past, it has been difficult to reconcile an accrual-based audit to a cash-based Form RD 1930-7, "Multiple Family Housing Project Budget," and that while the proposed rule indicates that an engagement letter will control the annual report process for projects with 16 or more units, one of the proposed program handbooks indicates that this is still an audit. The commenter noted that as such, the same situation may result—the Form RD 1930-7 is prepared on a cash basis, while the annual reports are prepared on an accrual basis. The commenter recommended that the bookkeeping system and reporting be consistent.

*Response:* The Agency thanks the commenter for introducing these issues and has modified § 3560.302(b)(1) of the interim final rule to say that the borrow

must conduct accounting, bookkeeping, and budget preparation in a manner consistent with the engagement.

*Topic:* One commenter said that § 3560.302 could be confusing to the independent accounting community because it states "borrowers must maintain records in a manner suitable for an audit or an engagement." The commenter said that an engagement can be several things: An audit, an audit performed to agreed upon procedures, a review, or a compilation, all of which are typically performed by CPAs. The commenter continued, saying that review and compilation engagements do not include procedures/tests to verify the accuracy of the amounts disclosed in financial statements, whereas audits are designed to do just that.

*Response:* The Agency thanks the commenter for this observation and has made changes to § 3560.302(a) to refer to maintaining "records in a manner suitable for an engagement," rather than to an audit or engagement.

*Topic:* One commenter contacted the AICPA and spoke with the Director of Professional Standards and Services, Ian A. MacKay, on July 11, 2003, more than halfway through the comment period on the proposed rule. The commenter found that the Director was not even aware of any changes being proposed by the Agency that would affect the accounting profession and auditing and urged that any planned changes to audit guidance must include and involve CPAs. The commenter believed that the Agency needs to engage and work with industry partners who are the experts in accounting before issuing the final rule. Another commenter echoed the idea that CPAs should be involved in writing the Agency policy and guidance on this topic.

*Response:* The Agency would like to reassure the commenters that CPAs and the HUD were consulted during the development of these policies.

*Topic:* Another commenter questioned whether the intent of § 3560.308(b) was for projects owned by the same owner and managed by the same manager to not be required to have separate audits for each property. The commenter stated a preference for having annual financial statements on all properties. One commenter suggested that in § 3560.308(b), the term "managing" general partner be defined as the partner responsible for operation under the partnership agreement. One commenter recommended removing § 3560.308(c) because if only a sample of housing projects were audited in a specific time period, audits conducted in later years would lack the necessary data inputs.

*Response:* The Agency appreciates the commenters' suggestions and has deleted in the interim final rule what was § 3560.308(b) in the proposed rule. All properties will be required to prepare annual financial statements, not just a sample number of properties.

*Topic:* One commenter stated that § 3560.308(d)(7) was too subjective.

*Response:* The Agency appreciates the commenter's concern. However, the Agency believes the standards are sufficiently objective to meet the needs of the Agency and borrowers.

*Topic:* Several commenters questioned the 2-year limit in § 3560.308(f), indicating that (1) most audit requests for proposals are for more than two years, and (2) required audit costs should always be an authorized project expense. Another commenter requested clarification on the procedures required by § 3560.308 after the initial 2-year period. Another commenter said that the proposed rule states that the Agency will approve a "full audit expense" for two years after the effective date of this regulation and questioned whether this is an attempt to get borrowers going with these audits and not worrying about the additional costs that they would incur doing these "full audits."

*Response:* The Agency thanks the commenters for highlighting this issue and has deleted § 3560.308(f) from the interim final rule. Annual financial statements are an allowable financial expense through the term of the property's Agency loan.

*Topic:* Regarding the proposed language for § 3560.305, several commenters stated that borrowers should be able to take their returns without prior authorization from the Agency. Other commenters said that § 3560.305 appears to allow an owner be paid a return that was earned several years prior but still not paid, provided sufficient funds are available to pay it. Some commenters thought that it was prudent to allow the borrower to accrue unpaid returns on investments, while others thought that the period for capturing the return should be limited. One commenter said that the proposed rule should limit how many years the borrower can go back and be paid earned but unpaid return on investment, which would possibly prevent large withdrawals on project accounts where borrowers have not collected their return on investment because of negative cash flow or their own discretion. One commenter said that if the audit confirms sufficient cash flow, which would allow for a return on investment, then the return on investment should be taken the next

year. The commenter went on to say that the Agency should allow for this return to not be taken "immediately after," but rather any time during the next year.

*Response:* The Agency notes these concerns and has modified § 3560.305(b) of the interim final rule to state that a borrower may only take a return that is accrued but unpaid for the previous year only. The interim final rule does not require the borrower to receive Agency approval before taking a return unless the project had a negative cash flow. The Agency believes that the period of time to recapture earned returns should be limited and believes this policy is in the best interest of the property. The borrower is permitted in § 3560.305 to take his return after the fiscal year. The Agency has removed the word "immediately" from the section discussed by the commenter.

*Topic:* Other commenters said that an owner's return should be treated like any other property operating expense and that the Agency should encourage owners to stay in the program instead of discouraging their involvement by establishing regulations and administrative processes that result in denying payment of an owner's return. Another commenter said that the timing for payment of accrued but unpaid return on investment is unclear and that owners should be allowed to accrue such returns indefinitely or until sale or other disposition of the owner's interest, since returns are paid from surplus cash, and do not affect the underlying real estate. One commenter said that rent increases should be allowed for a return on investment, which is part of the budget, and that the Agency's denying such a request constitutes a clear violation of the loan agreements. The commenter felt that if RHS cannot guarantee a return, it at least must permit the owner to seek that return.

*Response:* The Agency acknowledges the commenters' concerns; however, the return to owner is to be paid only when the project has surplus cash while being properly operated and maintained. If the property has adequate occupancy and is operating properly, then the net operating cash available at the end of the year would enable the borrower's return to be paid. The Agency does not believe the policies concerning returns on investment discourage participation in the program. However, a policy that permits unlimited accrual of such return could financially harm the property and the Agency's security. The return on investment is a budgeted line item and, combined with other operating costs, could be the basis for a rent increase. However, a rent increase based solely on

guaranteeing the return on investment is not permitted. Therefore the Agency has not adopted these suggestions.

*Topic:* One commenter said that consideration should be given to returns on investment for older projects and allow a return based on the current value of the original investment, which would help preserve existing projects because the return allowed is insignificant when compared to the property's current value.

*Response:* The Agency acknowledges the commenter's concern but has not modified the regulation at this time. However, the Agency will consider methods to implement such a change.

*Topic:* One commenter said that it appears from the language in the proposed rule that an owner may be paid for a return on investment that was earned several years prior but still not yet paid, provided sufficient funds are now available to pay it. The commenter asked if a project experiences a negative cash flow for the year and lacks sufficient surplus cash to pay the return, is it assumed that a return was not earned for that year and therefore could not be paid in subsequent years. If not, the commenter wanted to know if there is ever a situation where the return on investment is not earned.

*Response:* The Agency thanks the commenter for these suggestions. The borrower may carry accrued, unpaid distributions on the project balance sheet but only will be eligible to receive a distribution from the prior year. This can be found at § 3560.305(b) of the interim final rule.

*Topic:* Several commenters said that if the Agency approves a negative cash flow budget, then the return on investment should be paid because it is outside the borrower's control. They thought that payment of return should depend on whether there are sufficient funds to address the project's capital or operational needs. If reserves are funded as required, the commenter felt that the return on investment should be allowed and paid.

*Response:* The Agency acknowledges the commenters' concern. The Agency will only approve a negative cash flow budget at the beginning of the project's fiscal year if the property has sufficient cash on hand from the previous fiscal year. Under these circumstances, the borrower could be eligible to receive a return, but only with the Agency's prior approval. This can be found at § 3560.305(a)(2) of the interim final rule. The Agency does not believe the return is outside of the borrower's control because the borrower controls the budget. Further, the Agency has not adopted the suggestion to pay a return

if there are sufficient funds to address the project's capital or operational needs because the Agency needs to evaluate the performance of the property.

*Topic:* One commenter asked under what conditions, or with what justification, would the Agency authorize borrowers to be paid their return on investment, while at the same time their project is experiencing a negative cash flow. The commenter asked if these criteria are published to ensure their consistent use. Several commenters suggested that the borrower be prohibited from taking a return on investment from the project's reserve account.

*Response:* The Agency wishes to clarify this issue. The Agency may authorize that a return be paid to an owner when the property has a negative cash flow under very limited circumstances, as described in § 3560.305(a)(2) of the interim final rule—when surplus cash exists in the reserve account and the property has sufficient funds to address its capital needs. The Agency policy remains the same and the borrower is permitted, with Agency approval, to withdraw ROI from surplus cash in the reserve account. The Agency did not adopt the suggestion that the borrower be prohibited from taking a return on investment from the reserve account because taking this return has no adverse effect on the project.

*Topic:* One commenter said that the reference in § 3560.305(a)(2)(i) to § 3560.306(d)(2) should read § 3560.306(d)(1).

*Response:* The Agency thanks the commenter and has revised the reference in the interim final rule.

*Topic:* Regarding budget reviews and approvals, a substantial number of commenters decried the Agency's decision to have the budget submission date for borrowers requesting rent increases be 105 days before the end of the project's fiscal year. Commenters explained that this timeframe would require borrowers to prepare budget information so early in the project's fiscal year that they would have inadequate data—such as projected property taxes—to estimate the upcoming year's cost. Another commenter expressed approval of the proposed timeline. Another commenter said that the Agency should allow for rent increases on days other than the first day of the fiscal year because many management companies recertify all residents on a specific annual day. If that day is February 1, having a rent increase January 1 will require managing agents to implement a rent increase January 1 and then revise the

rent on February 1, doubling the workload. In addition, the commenter said that this will require Agency staff to update their records twice, increasing their workload. The commenter believed that allowing rent increases on days other than the first day of the fiscal year will decrease workloads and allow rent increase reviews to occur over a period of months. However, several Agency commenters said that the timeframe proposed for reviewing budgets with and without rent increases was a welcome addition.

*Response:* The Agency appreciates these comments and has revised § 3560.303(d) of the interim final rule to reflect the previous deadline for budget submissions of 90 days before the end of the project's fiscal year for a project for which a rent increase is being requested and of 60 days before the end of the project's fiscal year for a project for which a rent increase is not being requested. The Agency's streamlined budget processing also makes it possible for budgets to be reviewed on a more timely basis. The Agency wishes to note that there is nothing in the regulation that prohibits a borrower from submitting a rent increase request that will go into effect on a date other than on the first of the year. Further, § 3560.205 of the interim final rule allows requests for rent or utility allowance changes any time during the year if necessary to preserve the financial integrity of the housing complex and the circumstances are due to factors beyond the borrower's control.

*Topic:* Another commenter said that the Agency's new expedited review will free up Agency resources, which are stressed when all budgets come in at the same time, and will eliminate owners' having to operate their projects without approved budgets because of long waits for Agency approval. However, another commenter stated that the Agency has too many budgets to review at one time.

*Response:* The Agency thanks the commenter for this concurrence. The Agency is working to improve its management information systems to help expedite budget reviews, thereby enabling it to complete this task on time.

*Topic:* One commenter said that the proposed rule does not specify any thresholds and refers to budgets with "no rent increase."

*Response:* The Agency wishes to clarify this issue. "No rent increase" means that the borrower did not request a rent increase with the submitted budget package. Thresholds are addressed in § 3560.303(d) of the interim final rule, which describes

budgets and rent increases for which Agency approval is required.

*Topic:* One commenter said that the proposal to use thresholds when reviewing annual budgets seems good; however, there needs to be a way for the public to comment on the thresholds used.

*Response:* The Agency appreciates the comment; however, the thresholds are an internal program standard used to determine the level of Agency review. The thresholds are not part of the criteria used to determine whether the budget can be approved. Because the thresholds are part of internal program procedures, there is no obligation to allow public comment. The Agency does want to note that the public can easily find out the thresholds being used by obtaining the relevant Agency guidance about program procedures, which is readily available via the Internet or Agency Offices. Further, the Agency wants to emphasize that the criteria that borrowers must meet are provided in § 3560.303(a) of the interim final rule.

*Topic:* Several commenters said that the proposed rule should include the information contained in the current 7 CFR part 1930, subpart C, exhibit C whereby a budget is considered approved if the Agency approval official does not act on the request within 30 days. The commenters believed that this should include any budget, regardless if a rent change is requested.

*Response:* The Agency acknowledges the commenters' concern. Language was added to § 3560.303(d)(3)(ii) of the interim final rule to address budgets and automatic rent change procedures.

*Topic:* The Agency also received comments on the disposition of interest earned on the project's reserve account. Several commenters stated that letting the borrower retain 25 percent of the interest earned on reserve accounts helps offset taxes paid on phantom income. A few commenters felt that borrowers were not entitled to this benefit. Another commenter said that the criteria for Agency approval under § 3560.306(i) should be (1) A statement from a CPA in an audit or compilation regarding the amount of interest on reserves, and (2) a request to release 25 percent of that interest amount. The commenter said that this should not be calculated as return to owner; instead, this will mostly compensate owners for the tax burden from interest income as a return to owner. Someone commented that borrowers or management companies do not put the reserve account on higher yielding interest rate accounts because they do not get to keep the interest; there is no business

incentive. Further, to obtain higher interest yields, this commenter said that long-term commitments are required, and borrowers and agents may be afraid to have funds locked at a time when they may need the money for an emergency. Another commenter said that the proposed rule needs to limit the withdrawal of 25 percent of interest earned on reserve accounts to borrowers that deposit project funds in high interest-bearing accounts; at best, this is a break-even deal for the borrower, which is not a good incentive. Another commenter said that the annual return should equal 35 percent of the interest earned on reserve accounts, because 25 percent is not sufficient to compensate borrowers. Still, another said that the borrower should receive 100 percent of the interest earned on this account. One of the commenters concurs with the basic principle of the rule change to allow borrower's to keep up to 25 percent of the interest earned on reserve accounts, provided that the use of reserve fund interest to pay borrowers a return on investment (§ 3560.306(i)(2)(ii)) is conditioned on the deposits to the maintenance reserve account being on schedule. However, the commenter is opposed to any concession to limited profit owners that might result in underfunding the maintenance reserve.

*Response:* The Agency appreciates the commenters' concerns. The Agency will not consider the 25 percent of interest income as part of the return to owner. The Agency believes the 25 percent figure, as opposed to 35 percent or 100 percent, is a reasonable amount. The Agency will monitor this new policy and determine if any change is necessary. The Agency has attempted to provide borrowers with investment options so they are less limited by the size of the reserve account that may be invested. This policy allows borrowers to receive an amount to offset the effect of phantom income taxes. Borrowers are entitled to this amount if interest is earned on the reserve account. It is not dependent upon compliance with the reserve account funding schedule. Borrowers are encouraged to maximize their interest return as long as they remain in alignment with this rule.

*Topic:* One commenter said that § 3560.306(d)(2) of the proposed rule states that the borrower may need to deposit surplus general operating account funds into the reserve account "if the reserve account is not fully funded," but could not find a definition for "fully funded." Another commenter stated that borrowers should make required deposits until the reserve is fully funded.

*Response:* The Agency appreciates the commenters' questions and has revised § 3560.306(d)(2) of the interim final rule to state that the borrower will be required to deposit surplus general operating funds into the reserve account. This does not change the borrower's required contribution to the reserve account. This is because scheduled contributions are required until the account is fully funded as stated in the loan agreement.

*Topic:* With respect to § 3560.306(h)(3), one commenter said that the paragraph should read that borrowers may make an annual withdrawal from the reserve account equal to no more than 25 percent of the interest earned on a reserve account during the prior year, rather than on amounts earned. The commenter believed that this paragraph should state that interest income earned does not include any increased equity in the value of any reserve securities. Another commenter praised the new rule because it requires borrowers to record the price actually paid for securities when reserves are involved. The commenter said that this will help the Agency determine whether accounts have lost money and will also help determine that 25 percent of earnings to be released to the owner for taxes.

*Response:* The Agency acknowledges the first commenter's concern and has revised § 3560.306(h)(3) to read that borrowers may withdraw 25 percent of the interest earned on a reserve account during the prior year. The Agency believes this clarifies its position sufficiently. The Agency appreciates the second commenter's support of its position.

*Topic:* One commenter said that borrowers should not be able to take 25 percent of the earned interest out of the reserve account because interest earned is not phantom income; the interest is income earned on an asset, thus increasing the asset. The commenter continued that the value of the asset is higher because the interest is left with the property, and that there is already a problem with the reserve accounts not being adequate to cover needed capital improvements. Another commenter said that 25 percent of the interest earned only be given to the owner if the actual annual deposit to the account exceeds this amount.

*Response:* The Agency appreciates the commenters' position but does not agree that the disposition of the interest earned on the reserve account should be limited per the commenters' suggestions. The Agency understands that paying taxes on phantom income is a disincentive for staying in the program

and that allowing borrowers to receive a portion of the interest income earned on the reserve accounts helps to mitigate this disincentive. The Agency expects that 100 percent of the interest earned on the account will be deposited to the account. Twenty-five percent of that amount is available for withdrawal. The Agency will monitor this new policy and determine if any change is necessary.

*Topic:* Regarding allowable project expenses, several commenters stated that costs incurred in connection with alleged civil rights abuses by the borrower should be allowable project expenses if the borrower is not guilty. Other commenters said that the language in § 3560.303(b)(2)(v) is overly restrictive because if a judge overturned a management agent's eviction action, it would be for a violation of some portion of landlord—tenant law. The commenter said that regardless of how minor or insignificant the violation is, this would prevent the owner from billing the legitimate legal fees to the project; if owners end up paying for such legal fees, they will be less likely to pursue such actions, which might have a detrimental effect on other tenants.

*Response:* While the Agency takes civil rights abuses very seriously, it acknowledges that the borrower should not be required to pay for costs associated with frivolous lawsuits. Section 3560.303(b)(2)(v) has been revised to remove the term evictions and now states only that borrowers must pay for fines, penalties, and legal fees when they are found guilty of civil rights or other violations.

*Topic:* One commenter said that the proposed rule states that authorized purposes for project funds are described in the rule, but felt that § 3560.303(b) is not specific enough.

*Response:* The Agency acknowledges the commenter's concern. Allowable and unallowable project expenses are discussed in greater detail at § 3560.303(b) of the interim final rule.

*Topic:* Several comments were received on project payment for tenant services. One commenter said that the proposed rule should spell out the limits on how much project funds can be budgeted for tenant services. Another commenter suggested adding a section to the rule that allows a project controlled by a nonprofit corporation or public body to utilize operating revenues to pay for tenant services that enhance the tenant's quality of life. An additional commenter said that the value of tenant services in creating a healthy community is recognized by the MFH industry and that the Agency

encourages these services but does not allow them to be paid for from operating costs. A commenter said that HUD's project reengineering program allows tenant services to be paid for by project operating funds and that nonprofit organizations should be allowed to expense tenant services that enhance the tenant's quality of life (e.g., computer rooms, afterschool programs, etc.).

*Response:* The Agency has considered the comments but has decided to retain the language from the proposed rule at this time until it has time to further evaluate this issue.

*Topic:* One commenter noted that § 3560.302(c)(5)(iii) should state that uses of funds for nonprogram purposes does constitute a non-monetary default, not that it "may" constitute a non-monetary default.

*Response:* The Agency thanks the commenter for highlighting this issue and has made this change in the interim final rule.

*Topic:* The Agency received several comments on asset management fees. One commenter said that the proposed rule does not provide a definition for asset management fee. The commenter suggested that to facilitate the acquisition of Rural Development housing by nonprofit organizations, a reasonable and customary asset management fee be established; additionally, payment of asset management fees is inconsistent throughout the country. Another commenter asked the Agency to clarify that nonprofit organizations can obtain asset management fees consistent with current practice. However, one commenter strongly disagreed with allowing an asset management fee for nonprofit organizations. Another commenter said that the Agency should allow asset management fees as an allowable project expense as required by third-party entities, in conjunction with grants, loans, or equity.

*Response:* The Agency acknowledges the commenters' concerns. The Agency is not adopting a definition of "asset management fees" nor setting a "reasonable and customary management fee" because it feels this concept is sufficiently delineated in the provisions of this rule. The Agency allows nonprofit organizations to use housing project funds as asset management expenses directly attributable to ownership responsibilities. Section 3560.303(b)(1)(ii) of the interim final rule delineates the purposes of the asset management fee, which are reasonable and customary costs incurred by nonprofit organizations. While the Agency acknowledges commenter's

disagreement, it also recognizes that small nonprofit organizations often cannot afford to cover the time to perform property oversight functions or errors and omission insurance, and this oversight and coverage is important to ensuring the viability of the property.

*Topic:* Several commenters stated that supervised bank accounts are too cumbersome. Some of these commenters also stated that certain banks would no longer accept responsibility for dual signature accounts. Several individuals thought that the Agency micromanages reserve accounts because the borrower must submit a request for withdrawal of reserves to the local USDA office for review and approval with supporting documentation for eligible replacement items or residual receipts. Another commenter said that HUD and other affordable housing funders allow borrowers to operate their reserve accounts as legitimate needs dictate. Another commenter recommended that borrowers should be given more control over management of the reserve accounts, with USDA reviewing and verifying the accounts on a semiannual or annual basis.

*Response:* The Agency acknowledges the commenters' concerns. The Agency has determined that these requirements are necessary to enable RHS to meet its fiduciary responsibility to ensure that these funds are used for the purposes for which they were intended. The Agency does recognize, however, that technological and other changes may require different techniques to ensure the Agency's security. The Agency will review possible acceptable alternatives for the dual signature requirement. The Agency does not believe that (1) it micromanages reserve or operating accounts, (2) the requirements it imposes are unreasonable or cumbersome, and (3) that it can give borrowers more control over the management of the reserve accounts  
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*Topic:* One commenter noted that the postapproval requirement contained in § 3560.306(h)(5) should be discretionary with the Agency, but "extraordinary circumstances" should be revised to accommodate emergencies where prior approval is not practical and where there are delays in Servicing Office approvals.

*Response:* The Agency has revised the regulation at § 3560.306(g) to respond to emergency situations and will include further direction in internal Agency procedures. The Agency wants to emphasize that it has a fiduciary responsibility to ensure that these funds are used for the purpose for which they were intended.

*Topic:* Several comments were received on pre- and postapprovals of project reserve funds. One commenter said that to require preapproval of all expenditures from reserve accounts is unnecessarily burdensome; current practices at both HUD and many State housing agencies allow for postreporting in many instances—for instance, below a certain threshold dollar amount. The commenter recommended that the Agency modify this requirement to allow for postreporting of expenditures when the dollar amount is budgeted or when the amount is less than \$10,000. Conversely, another commenter said that a bad precedent will be set if the Agency begins to post-approve withdrawals from the reserve account based on the funds' being used for authorized purposes and having been approved by the Agency anyway, even if the proposed rule says that these will be approved only under "extraordinary circumstances."

*Response:* The Agency has revised § 3560.306(g) of the interim final rule to state that borrowers must inform the Agency of planned withdrawals when the project's budget is prepared. The Agency has not adopted a threshold requirement because the Agency feels it needs to evaluate program use and categorization of reserve accounts and due to the extensive problems the Agency has had with reserve accounts. In addition, the Agency has deleted from the interim final rule the statement in § 3560.306(g)(5) that it may postapprove the use of reserve funds only under extraordinary circumstances.

*Topic:* Numerous comments were received on § 3560.306 regarding the required deposits to the project's reserve accounts. The comments were similar to those described in the comments to subpart B.

*Response:* For the Agency's response, please refer to the discussion in the comments to subpart B.

*Topic:* Several commenters said that the proposed rule states that the required deposit amount will be an amount needed to maintain the property. They said that the methods of determining the amount need to be described in the program handbooks, or everyone will deposit the current 10 percent of the loan amount. The Office of Rural and Farmworker Housing agrees that maintenance reserve requirements should be revised (§§ 3560.65 and 3560.306). They said that history seems to indicate that the current one percent per year required contribution is insufficient; for the Agency to continue using one percent as a base would seem to invite the problems of the past, as some say this

amount is too high and some say it is too low. One commenter believed that the correct approach would be flexible and tied to the new requirement for including life-cycle cost analysis in the design and specifications of the proposed project (§ 3560.60(c)) and suggested that there should be two bases for funding the reserve accounts:

- One percent per year for 15 years for projects using materials with longer lives, such as brick siding and long-life heating equipment. During year 15, future maintenance needs would be calculated and the reserve conditions changed up or down as appropriate. In some cases, excess reserves should be returned to the owner as appropriate.
- One-and-a-half percent per year for 10 years for projects using average designs and specifications, with reevaluation performed during or after year 10.

*Response:* RHS has decided to publish an interim final rule that does not include § 3560.103(c)(3) and § 3560.306(k)(1) of the proposed rule, until their impacts can be assessed and policy decisions can be made for a long-term strategy. For the interim final rule, the Agency incorporated the relevant language from the existing regulation (7 CFR part 1930, subpart C).

*Topic:* Several commenters said that while increasing maintenance reserves will increase rents and therefore rental assistance costs in the short term, these increases should be balanced by smaller increases in the long run. They thought that the potential for deferred maintenance is more critical than the need for additional rental assistance with respect to the program's long-term success and its ability to serve the lowest-income rural residents.

*Response:* The Agency is in the process of evaluating the capital needs of the properties in the portfolio. However, over half of the residents in Agency-financed properties receive rental assistance; more than 93 percent of our residents are very low income and earn less than \$10,000 a year. Rental assistance will continue to be a very important component in the long-term success of the RHS MFH programs.

*Topic:* One commenter said that the proposed rule reads as if future reserve requirements would be imposed on existing projects, which may require an agreed upon change to the loan agreement by the owners. Regardless, this commenter thought that this is only possible if the Agency increased rental assistance and allows liberal rent increases. While the commenter wanted to see well-capitalized properties, additional reserves simply cannot be

expected without more income being provided to the projects.

*Response:* The Agency refers the commenter to the response for the two preceding topics.

*Topic:* One commenter asked the Agency to allow borrowers the flexibility to deposit funds irregularly over the course of the year, as long as they achieve the required annual deposit.

*Response:* The Agency agrees with the commenter's suggestion and has revised § 3560.306(c) of the interim final rule to address this comment and it is based on the language in the loan agreement as to the timing of deposits into the reserve account.

*Topic:* The Agency received a number of comments on the requirements for disposition of surplus operating funds and excess reserve account funds. Several commenters stated that excess reserve funds should be transferred to the property's operating account. Other commenters contended that borrowers should be allowed maximum flexibility in using surplus funds for the benefit of the project and that the borrower should be able to use excess reserves to make repairs and capital improvements and cover unexpected costs or unanticipated cost increases—in other words, for any project purpose when needed or to pay the return on investment. They thought that this language makes use of the excess reserves more restrictive than the use of reserves. Several commenters said that when a determination of surplus funds is made, it should take into account the upcoming year's budget of the project. One commenter said with regard to § 3560.306(d)(2) that rather than saying that if the housing project's general operating account has surplus funds at the end of the project's fiscal year, the Agency may require the borrower to use the funds to address the project's capital needs, with the word "may" being replaced with the word "will."

*Response:* The Agency appreciates these comments and has made several modifications to § 3560.306(d) in the interim final rule. These modifications should add flexibility to the requirements for transferring excess operating funds to the reserve account and determining whether the borrower is entitled to take a return on investment. The Agency has also revised § 3560.306(d)(2) in the interim final rule to read that the Agency will require the use of surplus operating funds to address the project's capital needs. Excess funds should be deposited to the reserve account because so doing: (1) Maintains Agency control and oversight; and (2) ensures

these funds are readily available for capital expenses and emergency needs. Use of surplus reserves is outlined in § 3560.306(k), all for the benefit of the project. Internal Agency procedures require evaluation of the upcoming project budget with reviewing surplus reserves.

*Topic:* A commenter asked if the priorities for using excess reserve funds shown in § 3560.306(l) are in order of importance.

*Response:* The Agency wishes to clarify this issue and has modified § 3560.306(k) of the interim final rule to read: "Amounts in the reserve account which exceed the total required by the loan or grant agreement must be used, at the direction of the Agency, for any of the following."

*Topic:* Several commenters stated that under § 3560.306(d)(1), the Agency seeks to keep excess funds to a maximum of 10 percent of the budget, which causes many properties to operate more thinly than is recommended and puts a property at financial risk to the normal vagaries of operations. They thought that prudent industry servicing should permit several months of funds to accumulate.

*Response:* The Agency thanks the commenters for their suggestions and has revised the interim final rule to state that the general operating account will be considered to contain surplus funds when the balance at the end of the project's fiscal year exceeds 20 percent of the budget. This can be found at § 3560.306(d)(1) of the interim final rule.

*Topic:* With regard to the requirements of initial operating capital, the Agency received a substantial number of comments. Comments received were similar to those described in the comments to subpart B. Several commenters said that the rule allows the developer to take the initial operating capital in more than one withdrawal within the 2- to 13-year period after a property is built, which decreases the developer's incentive to have a successful project as soon as possible. To these commenters, it appeared that there may be conflicting information as the summary indicates 2 to 7 years, while § 3560.304(c)(2) allows the developer 2 to 13 years to take the initial operating capital. Some commenters approved of this timeframe; some thought it was too short, and some thought it was too long.

*Response:* There was an error in the proposed rule and it should have stated that the developer may take the initial operating capital in more than one withdrawal in years 2 through 7, with

Agency approval. This can be found at § 3560.304 of the interim final rule.

*Topic:* Some commenters expressed skepticism regarding the benefits of this proposed rule change. One commenter questioned if there is an element of the borrower's desire to max out profit. The commenter went on to say that in today's market, owners are receiving an eight percent rate of return on their investment in their property, while the best any bank will do is a two or three percent.

*Response:* The Agency acknowledges the commenters' concerns but believes that the proposed rule change is more equitable to borrowers. Therefore, the Agency has not revised its regulatory language in the interim final rule.

*Topic:* Several comments were received on the Agency's requirements for project bank accounts. Most of these comments contended that the regulation should be permissive enough to allow for establishing accounts required by other funding sources, over and above the four that RHS requires. Another commenter said that § 3560.302(c)(5)(v) should be reworded to clarify whether commingling of accounts is acceptable between projects owned by the same borrower, or project owned by different borrowers but operated by the same entity. Another commenter said that the proposed rule states in § 3560.302(d)(1) and (d)(2) that the borrower may combine two or more housing project accounts, and in (d)(3) it says that they cannot if they are managed by the same management company. One commenter asked whether nonprofit organizations could have all program funds through one account as long as they are tracked separately for each program; if this is the case, the commenter wanted to see separate operating and maintenance accounts for the housing program, along with separate reserve accounts for each project.

*Response:* The Agency acknowledges the commenters' concerns. Section 3560.302(c)(3) in the interim final rule identifies permitted accounts, including account required by third-party lenders. The Agency has also revised § 3560.302(c)(5)(v) in the interim final rule to state that borrowers, including nonprofits, may operate one account for multiple projects as long the funds for each project are accounted for separately. Management companies may not commingle funds for multiple properties. This can be found at § 3560.302(d)(3).

*Topic:* Several commenters believed that the collateral requirements for project accounts are too restrictive. One commenter said that the Agency's proposal to use the cash in reserve

accounts as security for the Agency's loan does not address the issue of multiple lenders on projects. The individual thought that this requirement should be amended to address the mechanism to be used when multiple lenders, including the Agency, require this type of security. Some additional commenters expressed concern that the proposed rule does not address circumstances when borrowers have not adequately collateralized accounts that exceed the Federal Deposit Insurance Corporation (FDIC) insurance limit of \$100,000. Other commenters noted that the proposed rule continues and expands 7 CFR 1902.4(a)(5) to require collateral pledges for not just reserve accounts, but for all project accounts. They stated that this is a cumbersome, time-consuming, and unnecessary requirement. They favored simply continuing 7 CFR 1902.4(a)(5), which allows more flexibility because a collateral pledge only applies to reserve accounts, and even then a collateral pledge is not required if the financial institution has its accounts insured against theft and dishonesty. The commenter believed that the requirement for collateral pledges should be removed.

*Response:* The Agency notes the commenters' concerns. The Agency feels that security issues involving multiple lenders should be handled on a case by case basis. Regarding the comment concerning inadequate collateralization, the Agency makes an independent assessment of collateralization. If the Agency were to determine that the accounts were inadequately collateralized, then it would treat this as a non-monetary default. The Agency does not believe the collateral requirements are too restrictive. An alternative to collateral pledges are multiple accounts under \$100,000. Regarding the comment that collateral pledges now apply to all project accounts: that has always been the case. No change was made in this rule and the Agency continues to believe it is necessary to have these accounts pledged to support the loan. The identified collateral requirements establish a minimum threshold for protecting the Government's financial interest.

*Topic:* The Agency received several comments on this subpart related to life-cycle cost analyses. Comments received were similar to those described in the comments to subpart B.

*Response:* For the Agency's response, please refer to this discussion in the comments for subpart B.

*Topic:* One commenter expressed concern that little is stated in the

proposed rule concerning vacancies when preparing project budgets. Another commenter said, however, that the vacancy rate should be capped at 10 percent for properties with 15 or fewer units. Vacancies for properties with more than 15 units should have a maximum vacancy rate of 15 percent. Another commenter said that vacancies should be realistic given the project's history, but history is not defined.

*Response:* The Agency thanks the commenters for their observations. The methods for budgeting vacancy rates vary depending on each project's occupancy history and cannot be capped or based on number of units in the property. The Agency will provide additional details in its program procedures.

*Topic:* One commenter said that, as an alternative to management fees, the regulation should allow an administrative fee, possibly as a state's option. For example, in Mississippi, the management company is paid an all encompassing administrative fee that is intended to cover salary, paperwork, postage, etc., with the exception of training and auditing. The commenter noted that other states also use this system, and in all cases the reduction in micromanagement results in a much smoother cooperation between management companies and Agency personnel.

*Response:* The Agency thanks the commenter for this observation. The Agency understands the utility of having the property pay for a specific bundle of services for management and/or administrative services. The Agency describes this bundle of services in § 3560.102 (i)(3) of the interim final rule. However, the Agency cannot adopt this comment because it wants a nationwide, consistent fee structure through the management fee process rather than individual "state options" of administrative fees.

*Topic:* One commenter said that there must be ways for management companies to do a better job at being more frugal with their project budgets. Another commenter said that audits are reviewed on a first-come, first-served basis; there are so many to review in a short period of time in addition to other work demands. The commenter felt that there are opportunities for management companies to improve on their financial management during the year to avoid issues and questions during auditing times, as well as for auditors to provide clearer explanations on sources of expenditures or findings.

*Response:* The Agency thanks the commenters for sharing these concerns. The Agency designed the interim final

rule to provide guidelines to ensure that borrowers manage their properties as effectively and efficiently as possible.

*Topic:* One commenter said that if a borrower chooses to advance funds to properties to meet short-term needs, then the Agency should accommodate repayment. The commenter believed that the limited return limits the ability to repay advances even if funds are later available, and that RHS should allow owners a priority repayment to encourage advances to protect operations.

*Response:* The Agency appreciates the comment. The Agency has modified the regulation and allows repayment of such advances to projects to meet short-term needs, but prior Agency approval is required. This can be found at § 3560.307 of the interim final rule.

*Topic:* With regard to the borrower's financial management of Agency-financed multi-family housing, one commenter said that adequate documentation must be defined so it is objective, not subjective. This individual believed that adequate documentation should mean supporting documentation such as invoices, general ledger receipts, or other readily available information to support the books and records.

*Response:* The Agency thanks the commenter for this observation. Section 3560.302 of the interim final rule sets forth the Agency's basic requirements for project accounting, bookkeeping, budgeting, and financial management systems. "Adequate" or "supporting" documentation is any documentation required to substantiate the books, records and accounting systems.

*Topic:* One commenter noted that the requirement to notify tenants of rent increases should be compatible with State and local laws, and that there is no need for longer notification periods. Another commenter mirrored this concern and said that a 105-day notification period is too long, especially as rent increases would not be approved unless they were necessary and justified. The commenter believed that the current requirement for 60 days should be continued subject to State law.

*Response:* The Agency appreciates the commenters' concerns. As stated previously, the Agency has revised the budget submission timeline so that the process in the interim final rule is similar to that of the existing budget submission/tenant notification timeline. By revising some target dates, the Agency gives the tenant 90-day notification of the impending rent increase. Generally, State laws require a shorter timeframe for notification to

tenants, so the 90-day period should provide adequate notice.

*Topic:* Several commenters said that, in principle, they agree with the Agency's requirement to tie reserve for replacement deposit amounts to capital needs assessments, but that this policy could be used by borrowers to inflate project rents.

*Response:* RHS has decided to publish an interim final rule that does not include § 3560.103(c)(3) and § 3560.306(k)(1) of the proposed rule, until their impacts can be assessed and policy decisions can be made for a long-term strategy. For the interim final rule, the Agency incorporated the relevant language from the existing regulation (7 CFR part 1930, subpart C).

*Topic:* Several commenters noted that the Agency is not always in the senior debt position and that any senior debt needs to be reflected as a priority over Agency debt; since the Agency is allowing conventional loans to be in the senior debt position, this needs to be reflected throughout the regulations as necessary. Another commenter said that this is critical if the Agency wishes to continue leveraging other sources of debt, which is necessary given low program funding levels.

*Response:* The Agency appreciates the commenters' concerns and has revised in the interim final rule § 3560.303. This paragraph states that the first priority of planned and actual budget expenditures is the senior position lienholder, if any.

*Topic:* One commenter said that the proposed rule should explain the appeal rights available to the borrower if the borrower's proposed budget is rejected.

*Response:* While the Agency acknowledges the commenter's concern, the borrower's appeal rights are covered in § 3560.9 of the interim final rule and in greater detail in 7 CFR part 11.

*Topic:* Several commenters noted that some of the regulatory citations were incorrect:

- In § 3560.306(f), the section references should be § 3560.65 and § 3560.302(c)(5). Section 3560.305(f) should be changed to § 3560.306(f).
- Section 3560.306(m) references §§ 3560.102(c), (d), and (i). The correct references appear to refer to §§ 3560.102(g), (j), and (k).
- Section 3560.306(f) regarding funds invested in securities should refer to § 3560.306(g) instead of § 3560.305(f).

*Response:* The Agency thanks the commenters for their suggestions and has made these changes to the interim final rule.

*Topic:* One commenter said that § 3560.306 of the proposed rule needed "grammatical cleanup" and has "many long, run-together thoughts."

*Response:* The Agency acknowledges the commenter's concern and has substantially revised § 3560.306 in the interim final rule to be much clearer and more concise.

*Topic:* There were several comments about the Agency's proposed guidelines for investing reserve for replacement funds. Two commenters said that the proposed rule establishes very narrow guidelines for investing reserve funds—State- and Federal-backed securities and AAA-rated tax-exempt bonds. They thought that this latitude should be expanded to include investment funds commonly used by State and local Governmental organizations. For instance in California, housing authorities and public bodies routinely place funds in the Local Agency Investment Fund (LAIF). The commenters felt that such prudent State-sponsored investment funds should be allowable investments. In West Virginia, the monitoring and maintenance of investments necessitate significant staff time; significant losses have occurred in West Virginia when CDs have been pledged as security for nonproject loans.

*Response:* The Agency appreciates the commenters' concerns and has revised § 3560.306(f) in the interim final rule to allow for more flexibility in the investment of reserve funds but still requires reserves to be held at a Federally insured domestic institution. This policy ensures that the Agency maintains its fiduciary responsibilities.

#### Subpart H—Agency Monitoring

*Topic:* One commenter asked that the Agency revise the regulatory language in § 3560.352(c)(3) and in § 3560.352(b)(4) to remove "the Fair Housing Amendments Act of 1988" because this language is redundant with language earlier in the paragraph.

*Response:* The Agency appreciates the comment and has revised the regulatory language in both § 3560.352(c)(3) and § 3560.352(b)(4) to incorporate this suggestion.

*Topic:* Several comments were received regarding the Agency's monitoring techniques and borrower responsibilities. Commenters suggested including information related to inspections, supervisory visits, triannual supervisory visits, and compliance reviews in the final rule. One commenter expressed concern that the proposed rule did not describe how often onsite monitoring reviews would be performed nor the specific review procedures. However, another commenter expressed appreciation that the Agency did specify the frequency of monitoring activities in the proposed

rule because it gives the Agency the flexibility to “focus on the most important tasks and problem cases.”

*Response:* The Agency purposefully did not include the specific procedures in the interim final rule’s regulatory language, as was suggested by the commenters, in order to retain regulatory flexibility. However, the Agency describes its monitoring activities (e.g., timing of monitoring activities, items examined during monitoring activities) in its internal Agency procedures, which have been updated in conjunction with the issuance of the interim final rule.

*Topic:* Several commenters were concerned about the policy of scheduling onsite monitoring reviews without giving the borrower prior notice and whether the Agency has the right to enter private property without providing notice to property owners. The commenters requested some assurance for borrowers that tenant-landlord law will be followed. One commenter noted that onsite visits without notice could subject owners to greater insurance liability claims, and requested that borrowers “receive protection, financial and otherwise, from the Agency for any claims from tenants regarding a violation of their privacy rights based on the actions of Agency staff.” Another commenter suggested that staff seeking access for an Agency review should have some standard of notice as any unit inspection must comply with local tenant-landlord law to not disrupt either property operations or residents’ homes.

*Response:* The Agency recognizes the commenters’ concerns. The proposed rule specifies: “Generally, the Agency will provide the borrower prior notice of an onsite monitoring review \* \* \*.” In the interim final rule, the Agency has retained the authority to conduct onsite reviews without prior notice because RHS needs the flexibility to conduct these reviews in cases where it is not feasible to reach the borrower or give the borrower prior notice. The Agency has no interest in causing the borrower or the tenants any discomfort about the inspection process. We respect the tenant’s rights to privacy and the landlord’s responsibility to manage the property without interference from the Agency. However, there may be isolated instances in which the Agency needs to inspect the property or a unit as part of an emergency to protect the health and safety of the resident population and therefore the Agency reserves this right.

#### Subpart I—Servicing

*Topic:* One commenter indicated that the proposed rule gives almost no

attention to the problems associated with a significantly reduced Agency budget. The commenter also stated that the proposed rule does not adequately take into account the extent of leveraging of funds that currently occurs in the program and that has increased substantially in recent years. The commenter believed that the Agency’s policies tend to reflect the same perspective as when the Agency provided 100 percent of the funding. The commenter recommended that the regulation’s servicing requirements be relaxed or waived when other funding sources are participating in a project.

*Response:* The Agency acknowledges the commenter’s concern. However, the Agency wants to emphasize that it has made a number of changes in both its requirements and procedures for flexibility when multiple funding sources are involved in a project. There has been language added to § 3560.406 of the interim final rule that acknowledges the use of third-party loans and the ability to subordinate Agency loans. A change in internal Agency procedures is allowing the Agency to use appraisal reports and capital need assessments (CNA) from other funding sources provided the appraisal and “CNA” meet the guidelines as established by the Agency. The combination of these actions will reduce the duplication of work needed to finance these deals and expedite the current time frames.

*Topic:* Several comments were received on § 3560.405 and its requirement for borrowers to certify annually that there has been no change to the ownership entity. Commenters said that reporting organizational changes to the Agency would be unduly burdensome. Others were opposed to having proposed organizational changes approved by the Agency.

*Response:* The Agency does not require annual reporting but does require annual certification by the borrower. Only changes in the organizational structure need to be reported. Further, Agency approval is only required prior to a change in the controlling interest of the ownership entity. This responsibility is already a requirement under existing regulations, and these requirements provide the Agency with information that is fundamental to RHS in maintaining borrower accountability and ensuring compliance. For this reason, the Agency has made no change to this requirement in the interim final rule.

*Topic:* Regarding § 3560.405(a)(2), the commenters requested clarification to the definition of “substantial influence.” To illustrate potential points

of confusion, a commenter asked whether a limited partner with limited control rights that buys a 99 percent ownership interest or an instance of upper-tier syndicated ownership, such as the general partner of the 99 percent limited partner of the ownership entity, would be seen to exercise substantial influence. In both instances, the commenter believed that such entities may not exert substantial influence and asked that the Agency clarify this term. Another commenter asked whether the paragraph indicated that a management company had a controlling interest.

*Response:* The Agency has removed this paragraph. The guidance of the phrase “controlling interest” in § 3560.405(a) should be sufficient to describe a general partner in a limited partnership entity, rather than non-controlling limited partners or management agents.

*Topic:* One commenter addressed the Agency’s limited recourse when a borrower makes a change in ownership or transfer of ownership interest without Agency consent as outlined in § 3560.406(b). The commenter advised that when a borrower makes a change in organizational structure or transfers a title without Agency consent, the Agency should have the power to subject the project to restrictive-use provisions; moreover, if the new ownership entity or transferee will not execute a restrictive-use agreement, then the Agency should take steps to judicially impose such restrictions on the project.

*Response:* Failure to obtain Agency approval for a change in ownership or transfer of ownership interest is considered a default and handled in accordance with subpart J of the regulation. Subpart J of the regulation covers Special Servicing, Enforcement, Liquidation and Other Actions. A noncompliance issue of this nature could constitute the initiation of the liquidation process, or lesser penalties such as subjecting the borrower to civil money penalties provided in the new regulations. The imposition of a restrictive-use agreement does not deter someone from conducting this type of activity without prior approval. An action of this nature must be handled in accordance with the section of the interim final rule that imposes actions against owners who undertake actions without prior Agency approval.

*Topic:* The Agency received a comment recommending a change to the proposed rule allowing an exception to the processing limitations contained in § 3560.406(b)(2) for partners that were not present during a default or recent

substitution of partners approved by Rural Development.

*Response:* The Agency acknowledges the commenter's concern but the reference citation provided refers to "Ownership transfers or sales with an assumption of debt at an amount less than the borrower's debt amount will only be approved by the Agency when all persons in the borrower entity who are transferring their ownership interest or are involved in the selling of the property are not part of the transferee organization". The citation does not reference the presence of members during a default or recent substitution of partners.

*Topic:* Numerous comments were received asking the Agency to streamline its property transfer process. These comments included suggestions that there should be expedited processing of those transfers where purchasers seek to preserve affordable housing or rescue troubled properties. Several commenters said that to expedite the transfer process, environmental reviews should not be required when existing security property is being transferred.

*Response:* The Agency agrees with the intent behind many of the comments. The Agency is implementing procedural steps to streamline the transfer process. While the Agency acknowledges the commenters' concern about requiring an environmental review for all properties being sold, it has made no change because such a review is an established requirement of 7 CFR part 1940, subpart G.

*Topic:* Comments received by the Agency advocate for a firm time limit for processing transfers. One comment suggested a minimum of 60 days for processing. Others suggested that within 90 days of the submission of a transfer application, the appropriate State Office must process and approve or reject the application, and if the office rejects the application, then it must provide specific reasons and suggestions for approval. The commenter felt that if such action is not taken, then the Agency should allow applicants to pursue their application with the National Office.

*Response:* The Agency appreciates these comments but has not incorporated arbitrary processing timeframes in this interim final rule. While the Agency is committed to processing transfers as expeditiously as possible, the coordination of resources and action of all participants in the transactions makes the imposition of deadlines in all cases difficult and unreasonable.

*Topic:* With respect to the transfer of "at risk" properties, several commenters stated that the policy for the transfer and assumption of at risk MFH projects should be clearly defined in the proposed rule.

*Response:* The Agency appreciates these comments and notes that § 3560.406(b)(1) states: "Priority consideration will be given to ownership transfers or sales needed to remove a hardship to the borrower that was caused by circumstances beyond the borrower's control." Currently, this is the extent to which the Agency will go toward establishing a definition for at risk properties.

*Topic:* The Agency received comments that suggest at the closing of escrow accounts, the balance in each of the operating, tax and insurance, and reserve accounts should be released to the transferor, provided the transferee fully replaces the funds in each account.

*Response:* The Agency notes this concern and has revised the regulatory language to allow for the release of the reserve to the transferor. The release of these funds is contingent on the new owner funding the reserve account in an amount sufficient to cover the project's immediate needs.

*Topic:* Comments were received on the Agency's requirement for restrictive-use provisions for transferred properties. Several commenters said that purchasers should not be bound by these restrictions because doing so penalizes buyers and sellers seeking to stay in the program without further accommodation, by increasing the use restrictions. One commenter said that the Agency should track the format of HUD Notice 00-8 (available from HUD) for preserving section 236 properties. Another commenter noted that the proposed rule does not institute any new requirements with regard to restrictive-use provisions. The commenter went on to state that subordination is a serious servicing action and should carry with it a requirement for a new, extended restrictive-use agreement.

*Response:* While the Agency acknowledges the commenters' concerns, the Agency has made changes in the process throughout § 3560.406 to allow for equity at the time of transfer based on the period of time the borrower is willing to agree to restrictive-use provisions. Also at the time of transfer, it is the Agency's goal to have a Capital Needs Assessment completed and all necessary work completed through rehabilitation. It is the aim of the Agency to extend the useful life of the property through rehabilitation at least through the

restrictive-use period. The transfer process is being utilized to preserve the existing portfolio for years to come and provide the needed housing for those who otherwise could not afford it. The Agency has made no changes to § 3560.406(g) of the interim final rule. The Agency will continue to monitor this requirement to assess whether it serves to discourage transfers, which help preserve the supply of affordable housing.

*Topic:* Summarizing the views of several commenters, one commenter suggested that § 3560.406 "should provide a form use restriction agreement that can be amended for form for local legal and recording requirements." Commenters also suggested that when purchasers agree to both use such a form and extend existing use restrictions, then the purchaser should be able to obtain other Federal, state or local financing to pay for purchase and rehabilitation. They thought that RHS should agree to subordinate and, if requested, reamortize its existing section 515 loan. The commenters suggested that the Agency refer to HUD Notice 00-8 (available from HUD) for more information on such a transfer structure.

*Response:* In § 3560.406 of the interim final rule, the Agency encourages the use of third-party financiers in order to preserve affordable housing. This includes clarifying process requirements such as determining capital needs and simplifying servicing actions such as subordination or reamortization requests. The Agency streamlined the transfer process utilizing a new processing checklist to be used by Agency personnel for transfers which should expedite these type transactions.

*Topic:* The Agency received a comment suggesting that changes in or transfers of MFH ownership should only be approved by the Agency in cases where further availability of housing would be in the best interest of the resident and the Federal Government.

*Response:* The Agency appreciates this comment and has outlined a process to determine if the transfer would be in the best interest of the government in § 3560.406. This process takes into account current market conditions, need for the existing housing, existing condition of the property, and cost to rehabilitate the property in order to preserve the property for years to come. The Agency believes that the requirements regarding ownership transfer and sales adequately protect the Government's interest and the availability of affordable housing.

*Topic:* The Agency received comments on appraisals and security

issues. Several commenters questioned the use of the "as-improved value" for security property to be transferred. Several comments recommended using "as-is market value." One commenter stated: "There should not be a \$100,000 limit as long as the approval official documents that security is adequate," a concern echoed by several other commenters. One commenter urged that the word "market" be deleted from § 3560.406(d)(3)(i) because it creates confusion. According to the commenter, the value of the housing project should be a "prospective value-in-use," not a "market value." Other comments concerned the rights of purchasers to obtain an appraisal.

*Response:* The Agency acknowledges these concerns regarding the use of appraisal terminology and throughout § 3560.406, it has made revisions as necessary and appropriate. The requirements for determining the value of security property have been clarified and may be found in subpart P of this part. To determine what is in the best interest of the Government, the Agency determined that the appraisal process is necessary when the value of the property exceeds \$100,000.

*Topic:* Reflecting several commenters' concerns, one commenter said: "The subordination of interest or a junior lien will not cause the debt from all sources to exceed the value of the security property; however, total debt should be allowed to exceed the value of the property on a temporary basis during rehabilitation, provided the transferee can demonstrate that permanent financing will not exceed the value of the property."

*Response:* The Agency acknowledges this concern but has made no change because it believes that permitting total debt to exceed the value of the property fails to adequately protect the government's interest. This issue is addressed adequately in § 3560.409.

*Topic:* A commenter stated that CRCU should apply to initial loans, as well as to transfers.

*Response:* The Agency has made no change because initial loans are subject to CRCU as described in subpart B of this part.

*Topic:* The Agency received a comment regarding the proposed rule's remedy against an unauthorized junior lien, for which the Agency must declare a default and pursue liquidation of the borrower's loan. The commenter expressed concern with this approach, citing the Agency's obligation to preserve its housing stock. The commenter asked the Agency to explore other options outside of the acceleration and foreclosure process (e.g., enforce the

contract, impose fines on the borrower, seek a receivership, and impose continued use restrictions) and amend the regulation accordingly.

*Response:* The Agency is not required to pursue liquidation. The regulation provides for a cure period and opportunities for the borrower to resolve the issue. The Agency does not believe the regulation needs further amendment.

*Topic:* The Agency received comments expressing concern that the proposed rule does not allow project accounts to be encumbered by others. The commenters stated that this restriction is unrealistic and unnecessary, especially given the need to leverage other lenders' funds. According to one commenter: "Other lenders will want to encumber project accounts, and this should be allowed provided the Government's position is not unduly impaired," a statement that reflects other commenters' concerns.

*Response:* The Agency appreciates these comments but has decided to retain the language in the interim final rule. The Agency has decided not to change the rule because it already allows for liens under conditions that are advantageous to the project and to the Government and has determined that it is not appropriate to reduce its standards.

*Topic:* One commenter expressed that § 3560.406(e)(2) "should be modified to allow a non-Agency prior lien to also be transferred to the transferee if previously accepted by the Agency for the transferor."

*Response:* The Agency disagrees with the commenter. A non-Agency prior lien would reduce the equity and therefore, should be paid off before any equity is paid to the borrower.

*Topic:* One commenter indicated that § 3560.409 entitled "Subordination or junior liens against security property—other liens" appears to be unnecessary and duplicative of what is already in § 3560.408.

*Response:* The Agency appreciates this comment but disagrees that § 3560.409 is duplicative of § 3560.408. Section 3560.408 deals with the lease of security property and does not explain the procedures of § 3560.409, which deals with the subordination and junior liens against security property. In light of this, it is necessary to keep both sections as stated in the interim final rule.

*Topic:* Several commenters addressed the issue of final balloon payments that are routinely set up under section 515 loans. Under the current regulation, as loans approach the 30-year balloon payment, they may be reamortized as a servicing action, without the need to

extend any new funds. The commenters are concerned that the proposed rule discontinues this practice.

*Response:* The Agency wants to clarify that this practice is allowable and is addressed in § 3560.74. No change was needed.

*Topic:* One commenter requested that RHS or a third party provide training and assistance to existing owners and local groups to explain the responsibilities that come along with property ownership.

*Response:* The Agency agrees with the comment but training is outside of the scope of the regulation. The Agency is issuing administrative guidance on processing transfers more effectively. A training request should be forwarded to the Agency. This type of training can be provided on all levels. If such a request is received, the Agency will make every effort to accommodate the needs of its customers. It must also be noted though that with the Agency's current budget constraints, it would be advisable to also seek alternative solutions for obtaining this type training, such as housing organizations, non-profit training centers, etc.

*Topic:* A commenter asked whether all transfers would be for new rates.

*Response:* The Agency believes that § 3560.406(i) clearly states how the interest rate is determined in conjunction with an ownership transfer or sale. In most cases transfers will be based on new rates and terms in order to accommodate the preservation activity taking place with the transfer. In other instances loans will be transferred on new rates and terms if it is advantageous to the government. There may be some instances where transfers take place utilizing same rates and terms but only on rare occasion.

*Topic:* One commenter addressed the language used in § 3560.406. The commenter suggested changing all occurrences of "the transfer should be in the financial interest of the government" to "the transfer should not result in a negative impact to either the government or the tenants."

*Response:* The Agency appreciates the intent of this comment. However, the Agency has made no change to the language in the interim final rule to ensure that a transfer affirmatively achieves the goals of the program. This provision is based on the statute section 515(h) of title V of the Housing Act of 1949.

*Topic:* A commenter stated that local and State Rural Development offices do not have an adequate list of local nonprofit organizations. The commenter believed that Rural Development offices must be given assistance in developing

and maintaining up-to-date lists of active local nonprofit organizations and public bodies.

*Response:* The Agency appreciates this comment. The Agency works with local and State offices to ensure that they have the necessary materials and information they need. The implementation of the Prepayment Information Exchange (PIX) as mentioned in this document's discussion of subpart N will greatly improve the Agency's ability to maintain a complete listing of non-profit organizations interested in Agency rental programs.

*Topic:* One comment raised as an issue the practice that banks do not accept stocks as a form of collateral.

*Response:* The Agency notes that this comment is outside the scope of this regulation. The Agency has no control over what financial institutions accept as collateral and therefore has no authority to change and regulate the daily procedures of these institutions.

*Topic:* The Agency received a comment urging that a borrower and RHS give notice to residents that the borrower has applied to RHS to transfer the development to another entity. Further, the commenter believed that residents should be given an opportunity to comment on the transfer. The commenter thought that residents should be asked to report to the Agency any needed repairs and/or improvements in operations; if residents make legitimate suggestions, the Agency should include corrections of those issues as conditions for completing the transfer.

*Response:* The Agency appreciates the comment. However, the Agency does not believe the tenants need to be involved in a borrower's business transaction (transfer) that otherwise does not affect the availability or affordability of the rental housing. The Agency believes that the regulation as written requires identification of repairs and improvements needed prior to transfer approval.

*Topic:* One commenter identified an issue with the authority to transfer or sell developments under special rates, terms, and conditions as discussed in § 3560.406(l). According to the commenter, the authority fails to consider the Agency's statutory prepayment obligations. The commenter thought that the proposed rule would effectively authorize a borrower to sell a development outside the program restrictions whenever it is considered in the Government's best interest, that the section must be revised to also condition the sale upon the prepayment restrictions set out in subpart N.

*Response:* The Agency appreciates this comment but has determined that no change is required to the proposed regulation because § 3560.406(l) does not establish any criteria that would exempt new owners from being required to accept restrictions. Any project that would leave the program would be required to pay off the loan and leave the program in accordance with subpart N.

*Topic:* A commenter suggested that the Agency should allow for a reduction of the interest rate for the note at either the transfer of general partners' interest or the sale. According to the comment, many properties have interest rates approaching 18 percent. If the note could be reduced to a lower rate, then note rent could be lower, which could increase the possibility of attracting moderate-income applicants.

*Response:* In § 3560.406(i), the interim final rule allows for loan restructuring during such transactions to set the interest rate at the current level or at closing level, whichever is lower. This should address the commenter's concerns.

*Topic:* One commenter stated that current regulation and the proposed rule make it almost impossible for national nonprofit organizations to acquire properties. As such, the commenter thought that the definition of "nonprofit organization" in § 3560.11 must be revised and simplified to require only that entities be not-for-profit under section 501(c) of the Internal Revenue Code.

*Response:* The Agency acknowledges the commenter's concerns and has revised and simplified the definition of "nonprofit organization" in § 3560.11.

*Topic:* One commenter urged RHS to recognize the lack of market value in some properties that nonetheless serve an important resident and market need. The commenter asserted that RHS should revise its regulation to allow for recasting a portion of the existing loan as a soft note payable from cash flow. According to the commenter, this would most likely be needed where a portion of the section 515 loan could not be supported by existing income or where a portion of the existing section 515 loan, through subordination or otherwise, would be undersecured.

*Response:* The Agency acknowledges the commenter's position. The Agency is currently reviewing its ability to recast a portion of the loan as a note not requiring fixed installment payments (soft note).

*Topic:* A commenter expressed confusion regarding the type of third-party financing that is permitted given the language in § 3560.406(f).

Specifically, the commenter believed that the proposed rule limits the borrower's financing options.

*Response:* The Agency has rewritten § 3560.406(f) to more clearly state the borrower's options. These options state that equity funding to the borrower may be provided in cash or through a loan either by the Agency or through a 3rd party lender. This will enable the borrower to receive their equity from a 3rd party lender in the event the Agency is unable to provide the funding.

*Topic:* The Agency received a comment regarding the use of project funds for the purchase of computer equipment relating to industry interface and tenant certifications. The commenter believed that states are not modifying their security agreements to include this equipment. Further, the commenter indicated that costs have skyrocketed based on requests to use project funds for these purchases. The commenter believed that the proposed rule should address this issue.

*Response:* The Agency appreciates this comment, which requires a change in the security agreement to include the equipment at the property site. The Agency has modified the security agreement.

*Topic:* Two comments were received that encourage the Agency to revise the proposed rule to allow for the donation or below-market sale of portions of a MFH security property. They argued that the requirement of § 3560.407(b)(3)(i) that "the value of the security will not be reduced" is not adequately permissive to allow such transfers.

*Response:* The Agency appreciates this comment and has considered whether to adopt this recommendation. However, the Agency has made no change to the interim final rule because it has determined that while such a donation or below-market sale may benefit the owner, the project may not benefit from such action.

*Topic:* Several comments addressed § 3560.408(b), asking why borrowers are prohibited from leasing their property to public housing authorities and suggesting that there may be times when it is in the Government's interest to allow this practice.

*Response:* The Agency acknowledges the comments. However, the commenters did not provide any examples when it would be advantageous and therefore the Agency has declined to make the change in the regulation.

*Topic:* One comment was made regarding the requirement that lessees pay all prorated expenses associated with what is being leased. The

commenter believed that this may be difficult to determine and, instead, such lessees should only demonstrate that they are in the financial best interest of the project and tenants, and that the project itself will not be adversely affected financially.

*Response:* The Agency appreciates this comment but has made no change to the interim final rule. The rule is written to protect any expenses to the project that were not previously taken care of prior to the lessor leasing the property to the lessee. There is no way to know if some unforeseen expenses will adversely affect the property or not; therefore, by having rules in place to cover the cost ensures the financial stability of the property.

*Topic:* The Agency received a comment specifying that the new loans obtained by nonprofit purchasers seeking to acquire and preserve section 515 properties generally cover the following: (1) Cost of improvements or repairs, (2) a payment to seller, (3) purchaser's due diligence and transaction costs, (4) a debt service reserve for the new lender, and (5) lender's fee and cost of counsel. The commenter believed that nonprofit purchasers should not be expected to come out of pocket with monies to accomplish a preservation transaction.

*Response:* The Agency appreciates this comment but made no changes to the interim final rule. It is the Agency's position that these costs are part of the cost of doing business that every entity must be responsible for addressing.

*Topic:* A commenter stated that under existing regulations, phased properties could be consolidated as long as the entities were the same, regardless of when they were closed. A commenter asked whether this practice would still be allowed.

*Response:* The Agency acknowledges the commenter's position and there was no change in the new regulations. Consolidations are permitted as long as they are feasible and in the best interest of the government.

*Topic:* Several comments were received regarding loan consolidations. Commenters urged the Agency to add a paragraph to the regulation allowing loans for projects made to multiple borrowers to be consolidated when transferred to a new single borrower.

*Response:* The Agency wants to clarify that the proposed rule allows this type of loan consolidation and § 3560.410 of the interim final rule continues this policy. No change was needed. It should be noted that for a consolidation to occur the same borrower must own all projects that are to be consolidated. This common

ownership can occur after a transfer as described by the commenter.

#### **Subpart J—Special Servicing, Enforcement, Liquidation, and Other Actions**

*Topic:* The Agency received several comments expressing concern about a loophole related to acceleration that was not closed by the language in the proposed rule. Commenters noted that this loophole could allow borrowers to save their property during acceleration after the restrictive-use provisions have been removed and thereby circumvent the established prepayment process. Commenters stated that the loss of use restrictions after acceleration results in a loss of affordable housing, and some claimed that it is an approach used by owners to avoid being subjected to such provisions. Commenters requested that the Agency add language to the regulation allowing RHS to retain restrictive-use provisions on a property during and after acceleration and foreclosure.

*Response:* The Agency acknowledges these comments and has made revisions to the interim final rule to address owners that force acceleration in an effort to evade the prepayment process. The Agency has added language to § 3560.456 in the interim final rule that allows it to take alternative actions, such as suing for specific performance, when the Agency determines that the owner's motivation is to circumvent the prepayment process.

*Topic:* Several commenters requested that RHS adopt additional remedies and actions as part of special servicing actions. The objective of these remedies, proposed by commenters, is designed to preserve the supply of affordable housing. Suggested additional actions included being able to impose fines, appointing a receiver, recasting a portion of the RHS loan as a soft note payable from cash flow, and adding restrictive-use provisions in conjunction with special servicing actions, including loan restructuring.

*Response:* The Agency acknowledges the concerns raised by the commenters. RHS has authority to use a number of enforcement actions beyond those established in the current instruction. These additional actions have been incorporated into the interim final rule in § 3560.460 through § 3560.463 and have expanded the enforcement tools available to the Agency. RHS has also added the authority to require that expiring loan or assistance agreements not be extended unless the owner executes an agreement to comply with additional conditions prescribed by the

Agency, or executes a loan or assistance agreement in the form prescribed by the Agency. The Agency is currently reviewing its ability to recast a portion of the loan as a note not requiring fixed installment payments (soft note).

*Topic:* A commenter recommended that the Agency acknowledge that past servicing actions may have an impact on the cash flow for a project, which can affect a borrower's ability to address deteriorated physical conditions. The concern expressed is that some projects' cash flow may be insufficient to quickly correct deficiencies, particularly physical deficiencies. The commenter asked that the Agency explicitly recognize in the rule that some projects may need additional time to correct deficiencies due to the extent of funds available to the project.

*Response:* The Agency acknowledges that there are situations and circumstances that will require additional time to correct deficiencies. In such cases, the Agency requires the borrower to submit a workout agreement that identifies the time periods required to address these deficiencies.

*Topic:* A commenter requested that the regulation cross-reference 7 CFR part 1900, subpart D and the administrative appeals rules.

*Response:* The Agency notes that a cross reference to 7 CFR part 11 and 7 CFR part 1900, subpart D appears in §§ 3560.9 and 3560.10 of subpart A, and this reference continues in the interim final rule.

*Topic:* A commenter suggested that workout agreements should supersede management plans and requested that the Agency be required to notify an owner before canceling a workout agreement so that the owner has an opportunity to respond to Agency concerns.

*Response:* The Agency views the two documents—workout agreement and management plan—as serving distinct, but related, functions. RHS disagrees that the workout agreement should supersede the management plan. Rather, the two need to be consistent. The Agency has retained the language from the proposed rule in § 3560.453 (e)(i) of the interim final rule, which establishes that updating the management plan to be consistent with the content of the workout agreement is a condition of Agency approval of the workout agreement. Further, RHS has added language to § 3560.453(e)(2) of the interim final rule indicating that the Agency will provide notice to the borrower upon cancellation of the workout agreement for a property.

*Topic:* With regard to the occupancy waiver in § 3560.454(b), a commenter

raised the concern that the language as written could create an impasse at properties where the vacancy issue is the need for rental assistance and none is currently available. The commenter suggested that the requirement for housing applicants on the waiting list before any over-income applicant be revised so that it better matches with the availability of rental assistance.

*Response:* The Agency recognizes that in circumstances when RA is not available, higher income tenants need to be considered for occupancy and § 3560.454(b) of the interim final rule allows for this type of situation.

*Topic:* Multiple commenters requested that the Agency allow a borrower to reamortize its loan if the borrower is current with all payments. One commenter suggested that an appraisal should not be required as part of a reamortization regardless of debt, with proper cash flow.

*Response:* The Agency wants to clarify that a reamortization is allowable in these circumstances as is shown in § 3560.455(b)(3) of the interim final rule. The circumstances when appraisals are required are covered in § 3560.455(b)(3) of the interim final rule. As long as there is other adequate evidence that the Agency's security interest is protected as required by § 3560.455(b)(1)(ii), an appraisal would not be necessary. Finally, § 3560.454(b) of the interim final rule does allow for reamortizations in situations other than just delinquency.

*Topic:* A commenter requested further clarification from the Agency on the meaning of "suspending" rental assistance.

*Response:* Information regarding suspension of rental assistance can be found at § 3560.456(b)(2) of the interim final rule. The Agency notes that, generally, rental assistance is suspended when interest credit has been cancelled due to a default. The rental assistance can be restored once the default has been resolved.

*Topic:* A few commenters addressed the write-down provisions in § 3560.455. One commenter recommended that the Agency change the requirement from one write-down per property to one write-down per owner. Another commenter stated that the sections dealing with write-downs and reamortizations were excellent and would help maintain viable projects in very rural areas.

*Response:* The Agency agrees with the comment that requiring no previous write-down of indebtedness associated with a housing project as a condition to receive a write-down is too restrictive. The Agency has removed this condition

from the interim final rule. The Agency has not further restricted these requirements to one write-down per owner because the Agency does not believe the servicing remedy is necessarily related to the owner but rather to the performance of the property.

*Topic:* A commenter requested that the Agency allow for a write-down of debt without a change to the current ownership, if there are no issues with the ownership members.

*Response:* The Agency wants to clarify that the interim final rule does allow loan write-downs for the current ownership as specified in § 3560.455(c).

*Topic:* A commenter requested that § 3560.456 be revised to specifically include the ability to make a reasonable bid at a foreclosure sale. The commenter recommended that the regulation allow a discounted bid, as allowed by Single Family Housing, to include holding time, sale cost, and other factors.

*Response:* The Agency appreciates the commenter's suggestion and has incorporated the language from 7 CFR 3550 (at 3560.456(c)), which gives the Agency additional flexibility to accept a discounted bid.

*Topic:* In reference to § 3560.452, a commenter requested that the proposed rule explicitly allow RHS to extend the time period for correction or resolution of a default.

*Response:* The Agency notes that the proposed rule does allow for workout agreements to extend beyond 2 years. This provision under § 3560.453(e) allows the Agency to extend the period.

*Topic:* A few commenters requested that the Agency include a provision under § 3560.454 that would allow an applicant or resident who does not want to provide income and asset documentation, but is willing to pay market rent, be allowed to live in the property on an ineligible basis. Such residents would need to vacate the unit if needed by an eligible applicant.

*Response:* The Agency understands the commenters' concern but has made no change to § 3560.454. Under the applicable statute, RHS must have documentation of a tenant's eligibility for occupancy. Section 3560.454(b) and § 3560.158(c) allow for ineligible applicants to reside in a property with Agency approval if the specific unit type has no waiting list, or if accepting an over-income tenant is necessary to maintain the financial viability of a property. An Agency waiver is required in these circumstances, and only properties that have received a waiver may admit tenants that do not meet or will not document income eligibility requirements.

*Topic:* A few respondents commented on the authority of State and Field Offices to approve workout agreements and other special servicing actions. One commenter appreciated the Agency position of not requiring State Office approval of workout agreements longer than 2 years. Other commenters requested that the Agency provide the authority below the State Office for approval of Affirmative Fair Housing Marketing Plans, workout agreements, servicing market rents, and change of project designation.

*Response:* Approval levels are internal Agency procedure and not set forth in Agency regulations.

*Topic:* A few commenters noted that subpart J in the proposed rule did not include specific language on enforcement.

*Response:* The Agency has added four sections to the interim final rule to more specifically address enforcement: § 3560.460 (Double damages), § 3560.461 (Enforcement provisions), § 3560.462 (Money laundering), and § 3560.463 (Obstruction of Federal audits).

*Topic:* A commenter noted the actions that an owner may take or fail to take that would cause the Agency to determine that the loan is at risk. The commenter noted that the Agency may remove the management agent if the Agency determines that a compliance violation or loan default was caused, in full or in part, by the management agent. The commenter stated that it agreed with the Agency's strengthened ability to remove a management agent that causes compliance violations or loan defaults.

*Response:* The Agency appreciates the commenter's support.

*Topic:* A commenter inquired whether equity skimming is considered a non-monetary default under § 3560.462.

*Response:* The Agency appreciates this comment and agrees that equity skimming is a form of non-monetary default but has made no changes to § 3560.462. Additional procedural information on handling suspected cases of equity skimming are addressed in the Agency's internal procedures.

*Topic:* A commenter requested that the Agency provide clear definitions for when a payment is considered past due and how the Agency calculates 10-, 20-, and 30-days past due.

*Response:* The language in the definitions section of subpart A for "Default," and in §§ 3560.401(c) and 3560.451(c) has been revised to provide that a past due obligation is one which remains unpaid or unperformed for more than 30 days after the due date.

The references to 10 and 20 days in the proposed rule were clear and were not changed.

*Topic:* A commenter noted that § 3560.452(e) included an incorrect cross-reference to enforcement and liquidation sections.

*Response:* The Agency appreciates this comment and has corrected the cross-reference in the interim final rule.

*Topic:* A commenter noted that the discussion in § 3560.453 concerning workout agreement budgets does not reflect the fact that the Agency may not be the senior debt. The commenter recommended that the Agency add language reflecting Agency procedures when it is in a junior lien position.

*Response:* The Agency appreciates this comment and has added language to § 3560.453(d) in the interim final rule recognizing the prior lienholder's position, if any, in the order of cash disbursements under a workout agreement budget.

*Topic:* In reference to § 3560.454(e) regarding the termination of the management agreement, a commenter stated that the Agency must give the management agent and owner due process and allow them a joint opportunity to contest the termination.

*Response:* The Agency agrees with the commenter that the management agent and owner have the right to contest a termination but has made no changes to this section in the interim final rule because these rights are provided under the Agency's appeals procedures.

*Topic:* A commenter noted that procedures for the Debt Collection Improvement Act of 1996 were developed for the Agency, but that MFH was excluded because its own handbook was under development. The commenter recommended that the rule refer to 7 CFR part 3 covering debt collection for the Department or include language directly in the regulation.

*Response:* The Agency appreciates the comment and has added language regarding debt collection procedures to § 3560.460 in the interim final rule.

*Topic:* A few commenters noted typographical errors in §§ 3560.455 and 3560.456.

*Response:* The Agency appreciates these comments and has corrected these errors in the interim final rule.

*Topic:* A few commenters noted that § 3560.456(a)(2) regarding payment subsidy conflicts with guidance provided in the draft Project Servicing Handbook which was made available online when the proposed rule was published.

*Response:* The Agency appreciates this comment. The regulation is correct as written and changes have been made

to the Agency's internal procedures to ensure that it reflects the regulation.

*Topic:* With regard to § 3560.456(a)(2), a commenter asked whether the Agency needs to wait until the appeals process is complete, rather than immediately following acceleration, to suspend interest credit and rental assistance.

*Response:* The Agency has removed the phrase "immediately following the issuance of an acceleration notice" from the regulation to clarify that interest credit and rental assistance will be suspended upon acceleration.

*Topic:* With regard to § 3560.456(c), a commenter asked whether the Agency has the ability to foreclose on a mortgage without going through the U.S. Attorney's office, which can slow down the process.

*Response:* The Agency appreciates this comment but has made no changes because representation of the Agency by the Department of Justice is a Federal requirement and litigation is necessary to initiate a judicial foreclosure action in those states requiring judicial foreclosure.

*Topic:* A commenter stated that the Agency's procedures in dealing with deceased owners were unclear, in particular when there is no heir who wants to operate the property as affordable housing.

*Response:* The Agency appreciates this comment but the property is still subject to the restrictions and the Agency will work with the heirs, as necessary, to facilitate the transfer of the property to an eligible borrower.

#### **Subpart K—Management and Disposition of Real Estate Owned (REO) Properties**

*Topic:* A few commenters requested that preference be given to eligible nonprofit organizations for the disposition of REO property.

*Response:* Section 3560.504(c)(1) of the interim final rule has been revised to explain that the Agency will publicly solicit requests for sealed bids and publicize auctions. The successful bidder will be the applicant with the highest bid. It is the Agency's policy to get the best price for the property and not limit the potential pool of applicants.

*Topic:* A commenter requested that the Agency include language similar to the language from the current regulation in 7 CFR 1965.223(c), which provides for the continuation of restrictive-use provisions on projects sold out of inventory.

*Response:* The Agency appreciates this comment and believes its interim final rule adequately addresses this issue. When inventory properties are

sold as "program", then § 3560.505(d) of the interim final rule requires the loan closing follow the requirements of subpart B (see § 3560.62(a)(2) of the interim final rule) for executing a restrictive-use contract acceptable to the Agency.

*Topic:* A commenter requested that the Agency change the requirement for nonprofit organizations from having experience in the Agency's MFH programs to having experience in providing affordable housing.

*Response:* The Agency appreciates this comment but has determined that all applicants need experience in operating MFH to be eligible to own and manage this type of housing. The Agency notes that § 3560.102(e) of the interim final rule adequately covers acceptable management agent criteria and, therefore, determined that no change to the regulation is needed.

*Topic:* A commenter recommended that the Agency revise its policy stated in § 3560.504(c)(1) that the Agency will make an award to the first offer drawn as part of a sealed bid process for REO property. The commenter suggested that it would be in the Agency's interest to open all bids and accept the highest eligible bid.

*Response:* The Agency agrees with this comment and has revised § 3560.504(c)(1) of the interim final rule to clarify that RHS will accept the highest eligible bid or, if no acceptable bids are received, the Agency may negotiate a sale without further public notice.

#### **Subpart L—Off-Farm Labor Housing**

*Topic:* Several comments were received on § 3560.576 (formerly § 3560.575(b)(2) of the proposed rule) and the requirement that a substantial portion of income for Farm Labor Housing households come from farm labor employment. Commenters expressed concern that the standard for domestic and migrant farm laborers will increase so greatly that it will make many existing tenants ineligible, limit new occupancy, hurt the people that the program was intended to serve, and place existing properties at risk. Other commenters expressed concern because they were not able to see specifically how the income standard would change and there was no definition. One commenter also noted that exhibit J of RD Instruction 1944-D (available in any Rural Development office) has not been published annually by the Agency.

*Response:* Section 514 of the Housing Act of 1949 defines "domestic farm labor," in part, as "\* \* \* any person (and the family of such person) who receives a substantial portion of his or

her income from primary production of agriculture or aquaculture commodities \* \* \*." Previously, exhibit J of RD Instruction 1944-D (available in any Rural Development office) provided "Federal Regional Income Limits for Hired Farmworkers." Domestic farm laborers, other than migrant farmworkers, were required to earn actual dollars from farm labor for at least 65 percent of the annual income limits found in exhibit J. Migrant farmworkers were required to have at least 50 percent of the annual income limits. Exhibit J was distributed as a Procedural Notice on July 2, 1986, and has not been updated since that time. The proposed rule indicated that the Agency would be replacing exhibit J and updating the limits. However, the Agency has not changed its basic policy here in the interim final rule.

The Agency believes that commenters misunderstood the Agency's intent and the policy presented in the proposed rule. The examples provided suggest that the commenters interpreted the proposed rule as requiring the use of the income limits published by the Agency for eligibility in RRH as the basis for calculating 65 percent or 50 percent of income from farm labor. The Agency is not using the RRH income limits as the basis for the income standard for percentage of income from farm labor.

The Agency has retained the basic method used in § 3560.576(b)(2)(i)(A) of the interim final rule to determine whether a substantial portion of a household's income comes from farm labor employment. However, the Agency has raised the income limits that were previously published in exhibit J by 50 percent to reflect increases in farm worker incomes since 1986 (when the income limits were last published). When revising the income limits, the Agency used data from the Bureau of Labor Statistics. The new limits are found in internal Agency guidance and will be updated periodically, not annually, to reflect changes in the workforce. The changes will be announced in the **Federal Register** prior to the time that they take effect. The Agency has revised language from the proposed rule in an effort to clarify its policy on this topic.

*Topic:* One commenter questioned the statutory basis by which the Agency uses income to determine eligibility and stated that the proposed rule should comply with the statute. Further, the commenter added that if "Congress had intended to place income limits on tenants, it would have explicitly said so in the Act." Another commenter recommended that moderate-income farmworker families be able to live in

section 514/516 projects with continued use of the priority system (preferred no change to the existing system).

*Response:* The Agency has made no change to the current policy. Section 3560.576 of the interim final rule continues the current eligibility policy requirement that farmworkers must not have income which exceeds the moderate income limit (previously published at 7 CFR 1944.153) but will also continue to allow farmworkers with above moderate incomes to occupy units if there are no eligible applicants on the waiting list.

*Topic:* Several commenters were concerned with tenant priorities for off-farm labor housing. These commenters felt that the priorities were too confusing and cumbersome.

*Response:* The Agency agreed with these comments and has simplified the priorities in the interim final rule at § 3560.577(a).

*Topic:* One commenter said that priority for occupancy in off-farm labor housing should be based on annual household income, rather than on the percentage derived from farm labor.

*Response:* The Agency agrees with this comment and has eliminated this requirement from the interim final rule but still has to meet the definition of Domestic Farm Laborer which includes receiving a substantial portion of their income from the primary production of agricultural or aquacultural commodities or the handling of such commodities in the unprocessed stage.

*Topic:* A number of commenters felt that the requirements for a nonprofit organization should be simplified and that too much emphasis was placed on local representation. One commenter asked the Agency to use a standard definition of a nonprofit organization—one similar and/or used for other programs such as the LIHTC program. The commenter also thought it would be appropriate to include public agencies, such as public housing authorities and redevelopment Agencies.

Several others requested clarification on what "reflect the demographics of the community" means as opposed to "representation on the board from the area where the housing is located" because the proposed language in §§ 3560.55(a) and (b) does not speak to reflecting community demographics and § 3560.55(c) only lists additional eligibility requirements for nonprofit organizations. The commenters thought that the three sections do not address the instruction in § 3560.555(a)(1) that requires board representation from the housing area instead of a board that reflects the community's demographics. One commenter also stated that

paragraph (9) in the definition of nonprofit organization (§ 3560.11) requires "capacity" as an underwriting issue and should not be in the definition; the Agency should clarify its intent prior to finalizing the proposed rule.

*Response:* As stated in the description of comments for subpart A, the Agency agrees and has revised the definition of a nonprofit organization. The Agency has also added, language to § 3560.555 to specify that to be eligible for an off-farm labor housing loan or grant, a nonprofit organization must be a "broad-based" nonprofit organization. RHS has added this language so that the regulation is consistent with sections 514 and 516 of the Housing Act of 1949. The Agency has brought forward a sentence from the current regulation to describe what is meant by a "broad-based" nonprofit organization.

*Topic:* Several commenters questioned why limited partnerships were ineligible for Farm Labor Housing grants.

*Response:* The Agency notes that there is no authority under section 516 of the Housing Act of 1949 to provide grants to limited partnerships. For this reason, limited partnerships remain ineligible for Farm Labor Housing grants.

*Topic:* Several comments were received concerning § 3560.559, some of which concerned the requirement that off-farm labor housing incorporate exterior washing facilities (showers) as necessary to protect the resident and the property from excess dirt and chemical exposure. A few commenters thought that exterior washing facilities should be encouraged but not required.

*Response:* The Agency agrees with these comments and has revised its position in the interim final rule.

*Topic:* Another commenter thought that the Agency should use different terminology so that "washing facilities" is not confused with "laundry facilities."

*Response:* The Agency agrees with this comment and has changed "exterior washing" facilities to "outdoor showers, boot washing station, and/or hose bibb" in the interim final rule.

*Topic:* A commenter contended that exterior washing facilities were not needed and thought that the idea sounded discriminatory.

*Response:* The Agency does not agree with the commenter and believes that there are instances when outdoor showers can improve the quality of life of farmworkers by giving them the opportunity to wash off excess dirt and chemicals before entering their homes.

*Topic:* Several comments were received concerning construction

financing requirements for off-farm labor housing. These commenters want the Agency to allow grant funds to be used before loan funds to reduce interest costs.

*Response:* The Agency has made no change to the requirement because it contends that a borrower's own resources, including loans, need to be utilized prior to the disbursement of grant funds. The Agency notes, however, that this section of the regulation has been rewritten to state that equity contributions being made by the borrower or grantee must be contributed and disbursed prior to the disbursement of loan or grant funds.

*Topic:* One commenter also asked that the Agency include fees for oversight in its provisions for an asset management fee for owners of Farm Labor Housing projects that are not self-managed in subpart L. An additional comment wanted the Agency to allow an operating line item for the provision of services because the provision of services is used as criteria for funding projects by both Rural Development and some states.

*Response:* In the proposed rule, the Agency inadvertently left out the key language from the earlier Operating Subsidy Proposed Rule. The Agency has inserted the missing language into the interim final rule. The Agency believes that this additional language addresses the commenter's concerns. In accordance with § 3560.303(b), cooperatives and nonprofit organizations may use housing project funds, with prior Agency approval, for asset management expenses directly attributable to ownership responsibilities. The Agency has decided not to include a separate operating line item for the provision of services. However, if a Farm Labor Housing complex has a Tenant Services Plan and incurs administrative expenses while carrying out that Plan, those expenses can be budgeted for on the budget's "Other Administrative Expenses" line provided the expenses are directly attributable to housing project operations and are necessary to carry out successful operations.

*Topic:* A number of commenters expressed their concern with the distinction between off-farm and on-farm labor housing. One commenter noted that the Agency does not define the terms and suggested that they are used inconsistently.

*Response:* Definitions for the terms "On-farm labor housing" and "Off-farm labor housing" have been added to the definition section of the interim final rule in § 3560.11.

*Topic:* The Agency was asked by two commenters to provide more detail to § 3560.556. The first commenter asked that the Agency specifically use "may" instead of "will" in the final regulatory text and consider offering over-the-counter funds from time to time without being tied to a formal NOFA process. The second commenter asked to make § 3560.556 similar to § 3560.56 and to provide more detail. The commenter suggested that the minimum acceptable level of detail would be that a proposal or initial application should be submitted in accordance with the NOFA and those with the highest rankings will submit a final application.

*Response:* The NOFA that is annually published by the Agency contains much of the same detailed information that is found in § 3560.56. In this manner, the Agency will have more flexibility in modifying the application and processing procedures, without having to implement a change to the regulations. It may be necessary to have this flexibility to respond to changes in funding levels or shifts in program priorities. The Agency also retained the words "will be published" because the Agency will continue with a competitive application process, rather than making funds available "over-the-counter" from time to time, as suggested by the commenter.

*Topic:* One commenter asked the Agency to provide more flexibility in its occupancy limits for seasonal housing. The 6-month limit may be too restrictive, such as in the Northwest where seasonal work can last for 10 months per year. They offered that different units should be on a rolling seasonal schedule so that all do not close on one date, but perhaps on different dates throughout the off-months. The commenter also asked to have more flexible opening and closing dates for off-farm units.

*Response:* The Agency believes that the commenter misunderstood § 3560.60 as it does not establish an 8-month occupancy limit for seasonal housing. Section 3560.559 establishes a design requirement for off-farm labor housing that is housing occupied less than 8 months per year. The Agency has made one additional change from the proposed rule to allow seasonal housing to be constructed for full-year occupancy to provide additional flexibility with regard to this issue according to § 3560.559(a).

*Topic:* Two commenters were concerned with § 3560.562 and its use of the terms "security value" and "value-in-use," both of which one commenter asked the Agency to clarify in its final rule. Specifically, the

commenter thought that value-in-use should actually refer only to the value of the subject real estate, as restricted. The commenter felt that the problem with basing the term security value on the term value-in-use is that the value-in-use of a subject property, as restricted including the value of the interest credit subsidy, does represent security value, but the value-in-use of a subject property, as restricted including the value of the interest credit subsidy and the value of the section 516 grant, does not represent security value.

This commenter believed that there is a catch-22 for securing section 516 grants because their value must be added to the value-in-use of the subject property to secure the grant but value cannot be added because it does not represent security value. The commenter suggested revising §§ 3560.562(a) and (c) so that section 516 grants do not have to be secured by the value-in-use of the Farm Labor Housing project but instead, are based strictly on total development cost, not on security value.

The second commenter also had issues with the proposed regulatory language in that both the loan and grant must be securitized by the value of an appraisal or the total development cost, if it is less; yet, there are few comparable properties upon which to base "comps" in rural areas, so appraisals often come in below the total development costs. Since these rural area projects are often only feasible as a result of grants (RHS and others) the commenter requested that the Agency either not require an appraisal to cover the grant or allow exceptions to the appraisal requirements.

*Response:* The Agency acknowledges the commenters' concern and has revised §§ 3560.562(a) and (c) to clarify that the maximum amount of the grant is not limited by the security value of the property. The grant is limited to the lesser of: (1) 90 percent of the total development cost or (2) that portion of the total development cost which exceeds the sum of any amount provided by the applicant from their own resources plus the amount of any loans approved for the applicant, considering the capacity of the applicant to amortize the loan.

*Topic:* Multiple commenters asked whether it is practical (as stated at § 3560.565(b)(2) of the proposed rule) to lock the Agency into providing 100 percent of rental assistance if there are more affordable, alternate sources available.

*Response:* The Agency appreciates the comment and has revised the language

in § 3560.565(b) of the interim final rule to delete the 100 percent requirement.

*Topic:* A commenter wondered why the Agency allows the 50-year grant term to exceed the 33-year loan amortization period.

*Response:* The Agency has revised § 3560.566(c) of the interim final rule by removing the reference to a 50-year grant term. This was done so that the regulation is consistent with the grant agreement. The grant agreement requires that the housing be used for authorized purposes for as long as it is needed.

*Topic:* Several commenters focused on Agency requirements for loan and grant closings. One commenter suggested that all loan applicants should be executing loan agreements, and all such loan and grant agreements, regardless of applicant, should include the provisions listed in § 3560.571(b)(1) through (3). Three others asked the Agency to ensure that the documentation requirements for loan and grant closings are the same.

One of these commenters asked about the restrictive-use period, which the proposed rule states is specified in subpart N. They were uncertain if this referred to § 3560.662(a) with its 20-year restrictive-use period. They asked whether the Agency would disallow prepayment (commensurate with the section 515 program) and instead require a 33-year restrictive-use period (commensurate with the section 514 loan term).

*Response:* The Agency has deleted § 3560.571(b)(1) through (3) and has also revised § 3560.571 in the interim final rule to clarify the restrictive-use provisions for off-farm labor housing. Additional details are provided in § 3560.72(a)(2) and subpart N. The Agency agreed with the commenters and revised this section. The items that were listed in § 3560.571(b)(1) through (3) have been deleted from this section and have been placed in the Agency-approved loan and/or grant resolution, loan agreement, and grant agreement forms.

*Topic:* Two commenters stated that the Agency should include provisions governing the alternative option to use section 521 rental assistance as an operating subsidy in off-farm migrant labor projects. They added that the option was “enacted into law a number of years ago and there is no legitimate reason for omitting it here.”

Another commenter was disappointed that provisions for an operating subsidy on seasonal units was not incorporated into the Agency’s proposed rule.

*Response:* The Agency has adopted the language from the earlier Operating

Subsidy Proposed Rule for the interim final rule.

*Topic:* Two commenters expressed their support for the Agency’s effort to provide increased latitude in verifying Farm Labor Housing tenant income and farm employment.

*Response:* The Agency appreciates the commenters’ support for this provision.

*Topic:* The Agency heard from a commenter asking that provisions for section 514/516 technical assistance grants be included in the final rule.

*Response:* The Agency has adopted the commenter’s suggestion in the interim final rule at § 3560.553(b) and (c).

*Topic:* A commenter stated that § 3560.575(a) be modified to clarify that for Farm Labor Housing properties operated under the LIHTC program, the borrower may restrict occupancy to only those farm laborers who also qualify under the LIHTC program.

*Response:* The Agency has made no change because the tenants, by definition, must comply with the LIHTC program requirements.

*Topic:* Multiple commenters requested a reduced servicing requirement for grant-only projects, one for § 3560.577 and one for § 3560.578 (which is now § 3560.578 and § 3560.579 in the interim final rule).

*Response:* The Agency will not reduce servicing requirements for grant-only projects because RHS believes these activities are necessary to ensure the continued viability and compliance of such projects.

*Topic:* A commenter stated that § 3560.574 should be moved to subpart M since it deals with on-farm labor housing only.

*Response:* The Agency believes that the commenter may have misunderstood the intent of § 3560.574 since it does not deal with on-farm labor housing, so it has made no change.

*Topic:* One commenter saw no reason to distinguish between domestic and migrant farmworkers in the Agency’s programs. They anticipate that the 50 percent requirement included for migrant farmworkers would be less onerous to both residents and borrowers.

*Response:* The Agency has made no change because this distinction is necessary, since migrant farmworkers are the ones in greatest need and are the program’s primary focus.

*Topic:* Multiple commenters were interested in ensuring that surviving households be able to remain in housing but did not expect or think it reasonable for this to be a priority to gain tenancy.

*Response:* The Agency appreciates the comment and has deleted the provision

from § 3560.576(d)(1), which addresses a surviving household of a deceased farm laborer. The rights of surviving households to remain in their units are already addressed in § 3560.158.

*Topic:* Multiple commenters stated that developers are recognizing the need for senior Off-Farm Labor Housing projects and asked that the Agency expressly state that elderly Farm Labor Housing applications may be targeted for admission.

*Response:* The Agency has revised § 3560.576(b) and (c) to make retired farm laborers a priority for such housing, with “retired farm laborer” being defined in subpart A to be workers at or in excess of 55 years old. Although the Agency does not finance Farm Labor Housing projects that are restricted to the elderly, Farm Labor Housing should be marketed to *all* eligible persons, including, but not limited to, persons who meet the definition of a retired domestic farm laborer.

*Topic:* A commenter asked about the policy in § 3560.575(d) in which the Agency allows section 514/516 properties to be rented to non-farmworkers. The commenter notes this section does not provide a process for seeking approval or setting time limits and asks that a formal waiver process be included in the final rule.

Multiple commenters stated that the Agency should broaden its Farm Labor Housing statute definition to meet Congressional intent. One commenter suggested that the Agency mirror that of HUD (reference 42 U.S.C. 1436a(a)) and thereby address Congressional intent; specifically, the Agency should adopt the “legal or qualified alien” definition for all Farm Labor Housing, just as it has for other multi-family housing.

*Response:* The Agency appreciates the first commenter’s suggestion and has revised § 3560.575(d) in the Interim Final Rule to account for the suggested change. The Agency has made no change to the definitions because its requirements for citizenship are statutory.

*Topic:* A commenter asked that § 3560.575(d) be revised to address when areas cease to have farmworkers, which would include identifying the exception process to allow the development to permanently rent to non-farm laborers.

*Response:* The Agency has revised its proposal to identify a process by which non-farm laborer tenants are able to occupy units. In the interim final rule, § 3560.576(e), the Agency has reserved however, the authority for such units to revert to farm laborer tenants if the need again arises.

**Subpart M—On-Farm Labor Housing**

*Topic:* Commenters stated that as long as the Agency's loan is adequately secured, then the Agency should not prescribe what comprises adequate security.

*Response:* The Agency understands this point and has revised § 3560.610(b) to read: "When feasible, the on-farm labor housing will be located on a tract of land that is surveyed such that, for security purposes, it is considered separate and distinct from the farm. The security for the loan must include a lien on the tract of land where the on-farm labor housing is located and the security must have adequate value to protect the Federal Government's interest. The Agency will seek a first or parity lien position on Agency-financed property in all instances, however, the Agency may accept a junior lien position if the Federal Government's interests are adequately secured." This language is both less prescriptive and less restrictive and should address the commenters' concerns.

*Topic:* Regarding the on-farm labor housing program, several commenters said that rather than providing flexibility, the proposed regulation would add many restrictions that would disqualify agricultural housing providers. One commenter pointed out that the proposed regulation fails to recognize or provide a transition for owners with section 514 loans who agreed not to charge rent to their farmworkers.

*Response:* The Agency appreciates the commenters' concerns. However, the proposed regulations do not add any restrictions that are not currently in place. With respect to a transition for farmworkers who agreed not to charge rent, the regulations do not require that farmworkers pay rent; the regulations require that if rent is charged, it must first be approved by the Agency.

*Topic:* Several comments were received regarding the regulations on on-farm farm labor housing. Commenters were concerned that the regulation creates barriers to housing access for farmworkers and similarly disqualifies agricultural housing providers. One commenter noted that requiring proof of the tenant's eligibility prior to move in would make seasonal housing especially difficult to secure; in most cases, tenants do not usually have to certify their eligibility until after they move in. Another commenter noted that the proposed regulation would disqualify agricultural housing providers, such as a farmer with two or more employees, and such restrictions are unhelpful.

*Response:* The Agency does not know what was meant by the term "agricultural housing provider." However, the regulation does not make farmers with two or more employees ineligible. Requiring proof of tenant eligibility prior to move in simply conforms the on-farm regulations with other MFH provided by the Agency.

*Topic:* Commenters stated that the program should use language to facilitate growth of the Farm Labor Housing program and increased connections between affordable housing nonprofit organizations and farm owners. One commenter suggested that the program should be brought in line with other owned and operated rental properties by allowing a professional property manager firm to manage the property so that the farmers can concentrate on farming. Another commenter said that the proposed rule should allow limited partnerships to participate in the ownership of on-farm housing, similar to that done with LIHTC projects.

*Response:* The Agency acknowledges the commenters' concerns. While nonprofit organizations are allowed to work with farmers to develop on-farm labor housing by statute, this is not a specific objective of the program. While farmers are encouraged to manage their on-farm labor housing properties effectively, these are not conventional properties and should not be managed as such. However, there is nothing in the interim final rule to preclude professional management of on-farm labor housing projects. At the same time, the Agency does not anticipate the need for professional management except, perhaps, on rare occasions when there are a significant number of on-farm housing units at one farm. There is no statutory authority to allow on-farm labor housing loans to be made to limited partnerships.

*Topic:* One comment noted that in addition to the program objectives in § 3560.602, farmers should be allowed to receive grants as an incentive for providing affordable housing.

*Response:* Under section 516 of the Housing Act of 1949, only the following entities are eligible for farm labor housing grants: States or political subdivisions thereof, Indian tribes, broad-based public or private nonprofit organizations incorporated within the state, and nonprofit organizations of farmworkers incorporated within the state.

*Topic:* One commenter noted that the proposed rule should give leasing and renting priority to employees of the farmer but should also allow nonemployee agricultural workers an

opportunity to rent or lease a unit if the units are vacant for an extended amount of time. Another commenter noted that farm borrowers should be allowed, on a case-by-case basis, to provide housing for immediate relatives if the Agency can document that these family members are farmworkers in the best interest of both parties and essential for farm operation.

*Response:* The Agency acknowledges the commenters' concerns. The interim final rule gives the Agency the authority to provide exceptions to on-farm labor housing borrowers to enable them to rent to ineligibles on a temporary basis. The borrower must, however, demonstrate that efforts have been made to fill the units with eligible applicants.

*Topic:* Several comments were received concerning the limitations of the definitions of "farmer" and "farm owner" found in § 3560.11. Many commenters were concerned that such definitions might significantly restrict the pool of eligible farmer applicants. The commenter thought that this section should be amended to remove references to "family size farm" requirements and the reference to 7 CFR 1941.4. The commenter believed that the regulation "de-motivates" farmers who are legitimately interested in housing their workforce but cannot participate because they are not included in this definition. One commenter noted that the program should be available to all farmers on an equal basis because the one being helped is the farmworker, not the farmer; further, the section about ineligible farmers should be eliminated.

*Response:* The Agency acknowledges the commenters' concerns. The Agency has revised definitions of "farm" and "farm owner" in the interim final rule to be consistent with the current regulation and statute. In addition, a definition for "farm" is now included in the interim final rule. The revised definitions are less restrictive than those included in the proposed rule.

*Topic:* One commenter expressed concern that the proposed rule would increase the amount of work farmers have to do, especially when having to provide information from lenders indicating that they are unqualified to obtain credit from a commercial source.

*Response:* The Agency acknowledges the commenter's concern. The requirement that borrowers must provide documentation that they have sought credit elsewhere and have been refused is not a new one. The goal of the section 514 program is to provide financing to those who cannot obtain credit elsewhere. The "test for credit" requirement is a statutory requirement.

Section 3560.605(a)(3) of the interim final rule has been revised so that it is consistent with the statute and the prior regulation.

*Topic:* Several commenters expressed concern over the strong language about demonstrating that the farmer could not develop the housing without the USDA assistance. They felt that the requirement is counterproductive and should be removed; tying financing to borrowers' financial resources misses the mission of the Farm Labor Housing program.

*Response:* The Agency wishes to clarify the policy described by the commenters. Section 3560.605(a)(3) states that the applicant must be unable to provide the housing using the applicant's own resources. This is true for all the Agency's direct MFH loans. The Agency's mission is to provide financing for MFH in rural areas and/or for farmworkers by providing financing to those who cannot obtain it from another source. The requirement is a statutory requirement.

*Topic:* Several comments were received regarding the accessibility of the labor housing. One commenter noted that the farmer should only be required to add accessibility features on a reasonable accommodation basis rather than a mandatory feature; mandatory accessibility design feature requirements increase costs and may act as a disincentive for farmers to provide affordable housing for workers.

*Response:* The Agency acknowledges the commenters' concerns and has added § 3560.605(d) to state: "On-farm labor housing that consists of buildings with less than three units, need not meet the requirement that five percent of the units be constructed as fully accessible units, as described in § 3560.60(d)."

*Topic:* Several comments addressed site and construction requirements. One commenter said that all housing should be built to permanent unit requirements because of the low-construction quality and lack of maintenance of seasonal units. The commenter went on to suggest building an integrated community of permanent and seasonal worker units, which would be easier to maintain and manage.

*Response:* The Agency acknowledges the commenters' concerns and has modified § 3560.608(c)(2) to state: "Seasonal housing may be constructed in accordance with exhibit I of 7 CFR part 1924, subpart A. If constructed in accordance with exhibit I, the housing must be suitable to allow for conversion to full-year occupancy if the need for migrant farmworkers in the area declines."

*Topic:* There were several comments made concerning reserve accounts. One comment suggested that the reserve account requirement apply only when on-farm housing operations include 13 or more units, rather than the proposed number of five or more units. Another commenter noted that imposing standards on only five or more units sounds good but is an unnecessary burden and could discourage some farmers from applying.

*Response:* The Agency thanks the commenters for raising this issue and has modified § 3560.614 to state that the reserve account requirement applies when on-farm housing operations include 12 or more units.

*Topic:* Several comments were received regarding participation with other funding sources. One commenter noted that § 3560.615 cross-references § 3560.66, discussing the availability of rental assistance, but should make clear that on-farm labor housing projects may not receive rental assistance. Another commenter said that encouraging the use of other funding sources is incongruent with the rest of the proposed rule—the goal is to obtain nondebt financing for projects, not more debt financing. The commenter said that the regulation is written as if USDA were providing 100 percent of the financing, which is not always the case; this does nothing to help USDA partner with funding sources, an essential element.

*Response:* The Agency acknowledges the commenters' concerns. The reference to § 3560.66 in § 3560.615 refers to situations in which the borrower obtains other funding sources. With regard to additional funding sources, the Agency's intent is to encourage on-farm labor housing borrowers to obtain other funding sources, either debt or non-debt. There is no restriction against nonprofit organizations assisting farmers to obtain funds from other sources. Section 3560.254 has been revised to clarify that on-farm labor housing is not eligible for rental assistance.

*Topic:* One comment noted that the term of the loan should be 50 years instead of 33 years to allow for lower monthly debt service payments and lower monthly rent payments by the tenant.

*Response:* The Agency appreciates the commenter's concern but has made no change because the 33-year limit is statutory.

*Topic:* One commenter suggested that funds for on-farm labor housing should only be provided as permanent financing after the development work is complete.

*Response:* The Agency notes that on-farm labor housing borrowers are subject to the same financing requirements as off-farm labor housing and section 515 borrowers, as described in § 3560.71.

*Topic:* The Agency received several comments concerning housing management and occupancy restrictions. One commenter noted that on-farm labor housing borrowers generally have a single-family unit, where imposing a management plan requirement is burdensome for both Rural Development staff and the borrower.

*Response:* The Agency acknowledges these concerns. The requirements for management plans for on-farm labor housing projects are minimal.

*Topic:* Several comments were received concerning tenant eligibility. One commenter stated that any change in tenant eligibility should take previously existing tenants into consideration or grandfather them in. Another commenter noted that a definition of eligibility for Farm Labor Housing projects based on "annual income limits published by the Agency" will have very negative consequences for existing tenants; given that farmworkers are often some of the lowest paid workers, many of these tenants could be displaced if the proposed rule is adopted as currently written.

*Response:* The Agency acknowledges the commenters' concerns. However, the Agency wants to clarify that it has not changed the eligibility requirements for tenants of on-farm labor housing, and the annual income limits only apply to tenants of off-farm labor housing projects with a nonrestrictive farm labor clause, as stated in § 3560.575(b)(2)(iv).

*Topic:* One commenter noted that the proposed rule requires an Affirmative Fair Housing Marketing Plan even though on-farm labor housing is by definition restricted to employees only. The commenter thought that the regulatory language should explain clearly what is expected given these circumstances.

*Response:* Borrower's with on-farm labor housing loans for less than 5 units are not required to submit an Affirmative Fair Housing Marketing Plan. The Agency acknowledges that the Affirmative Fair Housing Marketing Plan might be an abbreviated version since the borrower is required to restrict occupancy to farm employees. However, the Agency intention is to ensure that there are no violations of fair housing and civil rights laws in providing on-farm labor housing.

*Topic:* Regarding establishing and modifying rental charges, one commenter noted that the Agency should only require sufficient financial information to show that the housing operation is operating in a nonprofit manner for the rental rate imposed. The commenter felt that the owners should be allowed the flexibility to provide budget information for the unit that is acceptable to the State Director.

*Response:* The Agency wishes to clarify the issue raised by the commenter. The interim final rule states that the borrower is to document the need for a rent increase and obtain approval from the Agency in accordance with subpart E. Subpart E does not specify what the borrower must submit to the Agency; only that "borrowers must fully document that changes to rents and utility allowances are necessary to cover housing or utility costs."

*Topic:* One commenter thought that the regulations pertaining to the on-farm program should continue to ensure that existing borrowers not charge rent to their laborers.

*Response:* The Agency appreciates the comment. The Agency's policy is that the on-farm borrower can choose to charge rent or not. The interim final rule provides the option in § 3560.628 by stating "If it becomes necessary to establish or modify a shelter cost, the borrower must obtain Agency approval as specified in subpart E of this part."

*Topic:* One comment was received regarding security deposits. The commenter noted that this should only be addressed as required lease language and make no reference to multi-family regulations as stated as § 3560.204.

*Response:* The Agency wishes to clarify this issue. On-farm labor housing borrowers are not required to charge security deposits. If they choose to do so, however, the terms set forth in § 3560.204 must be followed to protect both the tenant and borrower and ensure that the borrower is in compliance with applicable State and local laws.

#### **Subpart N—Housing Preservation**

*Topic:* The Agency received numerous comments on the sale to nonprofit organizations or to public agencies and the priority for local nonprofits. Some commenters indicated that this requirement is too restrictive and will slow down the preservation process as it limits the entities that can participate. Some suggested broadening the definition of nonprofits to facilitate the participation of National and regional nonprofit organizations (which are limited by the board composition

requirements under the current definition), as well as nonprofit general partners who otherwise agree to the use restrictions (which would allow for the use of LIHTCs and tax-exempt bonds). Others suggested eliminating the preference all together to allow for limited nonprofit and for-profit entities that agree to use restrictions. Other commenters, however, stated that the priority of nonprofit buyers is critical to the preservation of affordable housing and should be made more explicit in the regulation. It was also suggested that nonprofits be offered all available incentives to assist them in acquiring and preserving properties.

*Response:* The Agency has not removed the sale to the nonprofit organization and public body process from the interim final rule because the requirement is statutory. However, the Agency has simplified the definition, as stated above under subpart A. The rule will retain the preference to local nonprofits, as that is required by statute as well. The Agency has also taken several administrative and procedural steps to facilitate nonprofit purchases by providing them better access to loans and advances.

*Topic:* The Agency received numerous comments about restrictive-use provisions. Comments fell into four major categories:

- A lack of clarity about how the provisions are determined,
- Opposition to restrictive-use provisions,
- A call for greater use and enforcement of restrictive-use provisions, and
- The impact of the restrictive-use provisions on future transfers.

*Topic:* There were general complaints about lack of clarity about the Agency's regulatory authority to require restrictive-use provisions and the process by which they are determined. Commenters raised questions about specific dates cited in the rule, the application of the requirements to limited partnerships, language on affected households, and the exception for properties receiving another USDA loan. They also argued that there are no standards laid out in the rule for determining the applicable-use restrictions and objected to language stating that the provisions will be "as determined by the Agency."

*Response:* The Agency acknowledges the commenters' concern and while the requirements are statutory, the Agency has revised § 3560.658 and § 3560.662 to clarify its requirements and provide the terms of the restriction. The statute (42 U.S.C. 1472(c)) specifies which loans are subject to restrictive-use provisions

and provides the terms of the restriction. The Agency cannot change this. The Agency incorporated the specific language for restrictions into forms, guided by the detailed descriptions at § 3560.662.

*Topic:* There were also significant objections to the restrictive-use provisions in general. Commenters indicated that these provisions place an undue burden on borrowers who have already fulfilled the obligations of their agreements. Commenters also indicated that, in some cases, the restrictive-use provisions are not needed (e.g., in areas where other housing opportunities exist or in properties where other loans place restrictive-use provisions on the property). They also questioned the 10- and 20-year extensions to use restrictions.

*Response:* The Agency has not removed the requirement for restrictive-use provisions because it is statutory. However, the rule does allow alternative options for properties that are not needed in the program or have other restrictions in place. The Agency added the 10-year use restriction to provide owners with additional options when agreeing to sell to a nonprofit organization or public body, rather than imposing additional requirements.

*Topic:* Several commenters stressed the need for effective enforcement of the restrictive-use provisions. They indicated that tenant involvement is important to enforcement efforts but that Agency action will be important as well. They suggested that language about Agency enforcement of provisions be included in the applicable legal documents. Commenters also expressed concern that some properties have not had restrictive-use provisions applied because of their section 8 status. They indicated that a property might lose its section 8 assistance and no longer be subject to affordability requirements.

*Response:* The Agency will use the resources it has available to enforce its restrictive-use provisions; however, the involvement of tenants and other interested parties will be critical to maximizing the Agency's enforcement resources. The restrictive-use provisions required by § 3560.662 will have to be included in Agency approved legal documents. Current regulations require that the availability of section 8 will not be considered when determining if restrictions are required. The Agency contemplates no change in that administrative process.

*Topic:* Several commenters stated that the proposed rule places another restriction on the property if bought by a nonprofit/public body—not only must it be operated as affordable housing for

the remaining useful life of the housing, but it cannot be transferred to new owners without Agency concurrence. The commenters asked why the Agency must approve subsequent transfers if restrictive-use provisions bind the purchasers.

*Response:* The Agency acknowledges the commenters' concerns but has made no change to § 3560.659 as this requirement is required by 42 U.S.C. 1472(c)(5)(E).

*Topic:* The list of requirements for prepayment requests drew many comments and question on this list of items, the burden of complying, and how to comply.

*Topic:* The Agency received numerous comments on the list of items required for a preservation application and suggested edits and changes. Several commenters said that requirement to provide 3 years of operating budgets should be eliminated because if the purchaser provides the Agency with a market study, the Agency should be assured that the market rents are sufficient to cover the property's operating costs. Several commenters, however, suggested that the requirement for a market study be eliminated because of the cost factor involved, unless the cost can be funded through incentives. Commenters also suggested that the requirement to provide a balance sheet be eliminated, as the Agency should already have a copy, and that the request for the waiting list should be eliminated because it is irrelevant in determining prepayment eligibility. One commenter also suggested that the Agency distinguish between "complete information" and "responsive information" as a way to pare down the materials to be submitted.

*Response:* The Agency appreciates these comments and has significantly reduced the number of submissions, eliminating the requirements for the balance sheet, waiting list, operating budgets, and market study. The remaining required submissions include only evidence of the borrower's ability to prepay and documentation of the borrower's willingness to comply with applicable State and Federal laws on prepayment, including Fair Housing rules and tenant protection through the lease. With this greatly reduced reporting burden the Agency sees no need for a further delineation between "complete" and "responsive" submissions.

*Topic:* The requirements for prepayment requests also elicited numerous comments and questions about the burden associated with the application packet. Some stated that the

amount of information required posed a burden on the borrowers and that the Agency should take on more responsibilities as outlined in the Emergency Low Income Housing Preservation Act (ELIPHA). One commenter indicated that compliance with State laws is important and agreed that the burden should be on the borrower to demonstrate compliance.

*Response:* The Agency has made a serious effort to balance the burden of compliance with the Agency's responsibility to assess the prepayment requests. The changes discussed above reduce the borrower's burden considerably without jeopardizing the Agency's ability to assess the request.

*Topic:* Finally, commenters raised a number of questions about the contents of prepayment requests, specifically, how to demonstrate ability to prepay, lease language on prepayment, and the Fair Housing certification.

*Response:* The Interim Final Rule outlines the required submissions while leaving the detail on how to submit them in the handbook. The Agency recognizes the complexity of these issues and provides additional detail on how the Agency will make these review determinations in Agency guidance about program procedures.

*Topic:* The Agency received many comments on the prepayment notice requirements, regarding the new frequency of the notices, the tenant/Agency meetings, the way notice is provided, and responsibilities regarding new tenants.

*Topic:* Commenters offered different points of view on the new prepayment notice and meeting requirements. Some argued that the new notices and the Agency meeting are overly burdensome and tend to cause confusion among tenants rather than provide useful information. However, others stressed the critical importance of informing tenants through the notices and meetings, and argued for further requirements to strengthen the notice requirements, such as requiring borrowers to provide tenant names and addresses as part of their prepayment application, allowing greater response time for tenants, and including the sample notices, currently found in internal Agency guidance. Commenters also had suggestions for the delivery of the notices related to the language, the use of regular versus certified mail, and the Agency's responsibility for delivering the notices.

*Response:* The Agency appreciates all the comments. The notices as outlined in the proposed rule are not new and represent, in the Agency's estimation, the best compromise between burden

for the borrowers and for the Agency and the tenants' need for information. For example, the Agency automated information system called MFIS currently contains information on tenant names and addresses, and their income status, so borrower provision of these data is redundant and was eliminated. The rule establishes minimum requirements for keeping tenants adequately informed of the prepayment process at all stages including response times. All notices must be approved by the Agency and the Agency will consider adopting a pre-approved sample notice. The Agency feels that a further level of detail is unnecessary in its regulations. The Agency will issue subsequent guidance on approved notice procedures including content and delivery and how the notification process fits into the prepayment process. The Agency's regulations do not require it to provide the notices.

*Topic:* One commenter raised an issue regarding the notification of new tenants after a borrower has applied to prepay a loan. The commenter indicated that some borrowers might use this provision to warn potential tenants about the potential changes in the property to discourage low-income tenants from taking the units, thereby reducing their prepayment obligations. The commenter asserted that provisions should be put in the rule to limit this behavior.

*Response:* The Agency acknowledges this comment. However, based on the Agency's experience as it has worked with borrowers during the prepayment process, RHS has found that this type of action is not common practice. Further, the significant loss of rental revenue that would occur if borrowers took this type of action in an effort to obtain possible relief from prepayment obligations to tenants is a strong disincentive against this practice. For this reason, the Agency decided to make no change to the interim final rule.

*Topic:* The Agency received many comments on the timeframes established for receiving incentives and closing deals with nonprofit organizations or public agencies. On the 15-month timeframe for receiving incentives, several commenters stated that the new process is not significantly improved and urged additional streamlining to reduce the 15-month wait time. Others stressed the importance of securing adequate funding in the Agency budget to meet the 15-month deadline. Still others opposed the 15-month cap, stating that it violates the Agency's responsibilities under ELIPHA to preserve housing and

will allow borrowers to opt out. On the 24-month timeframe, several commenters welcomed the limit but requested that an exception be made in cases where the purchaser has not received adequate cooperation from the Agency or the borrower. Some argued for a 48-month timeframe to address the intense competition for resources, while others stated that 24-months is commercially unreasonable. Some commented on wait list procedures and proposed putting borrowers on the list sooner to speed up the process.

*Response:* The Agency acknowledges the commenters' concerns and has revised § 3560.660(a) to incorporate the suggestion for an exception to the 24-month deadline. The Agency has significantly reduced the waiting period for incentives since the proposed rule was published and expects that performance to continue. Otherwise, the timeframes and wait list procedures remain in effect, as the most feasible compromises among the various interests. Additional details on these timeframes and procedures are covered in Agency guidance about program procedures. The Agency appreciates the commenter's suggestions about the borrower's desire to opt out but hopes to have sufficient resources available so that the waiting list timeframes remain relatively short, although overall program funding is not under the control of the Agency. We also note that borrow cooperation is a critical component to help meet timeframes. For wait list integrity, the borrower must accept an incentive offer before they can establish a position on the waiting list.

*Topic:* Several comments were received regarding the third party financing in preservation transactions. Several commenters said that the proposed rule does not enumerate the authorities that permit use of third party financing and instead refers back to subpart I. The commenters further state that § 3560.406(f) prohibits the use of project funds to pay for such financing, which effectively eliminates all third-party financing options.

*Response:* The Agency thanks the commenters for highlighting this issue and has modified § 3560.406(f) so that it does not eliminate participation of third party financing during the transfer process. Also, § 3560.657 clarifies that third party loans are acceptable as part of the prepayment process. The Agency has been and intends to continue using third party financing as an option when prepayment is requested.

*Topic:* Commenters also discussed third-party loans as possible incentives. They asked that provisions be added to the rule to specifically allow borrowers

to obtain an outside equity loan as a possible incentive. Commenters also asked the Agency to revise the regulation to more clearly recognize the range of financing mechanisms it has recently implemented through Administrative Notices that allow third parties to bring private and public financing into the section 515 program.

*Response:* The Agency finds that the interim final rule allows third party financing in § 3560.659(g). Third-party equity loans are permissible as long as they are approved by the Agency in accordance with subpart I.

*Topic:* The Agency also heard from commenters focused on appraisal issues under subpart N. Several of these commenters stated that the requirement for two appraisals, especially for a sale to a nonprofit organization, is excessive. They stated that if the borrower and the Agency can agree to a sales price after one appraisal is conducted, then a second one should not be required. Similarly, commenters suggested that if the difference between the two appraisals is less than 10 percent they should split the difference, rather than seek a third appraisal. Commenters also suggested that to help streamline the process, the Agency should allow for the owner to provide an appraisal, subject to review and approval by the Agency. Finally, there were some comments indicating that the appraisal requirements are not clear.

*Response:* While the Agency appreciates these suggestions, it has made no change because the requirement for two or three appraisals is statutory. In response to several commenters who stated that the appraisal requirements are confusing, the Agency recommends reviewing subpart P of this part for detailed information on appraisal requirements.

*Topic:* The Agency received several comments on identity-of-interest relationships in preservation transactions. These commenters said that prohibiting any identity-of-interest between seller and buyers, particularly nonprofit buyers, punishes persons who seek to convert ownership from for-profit to nonprofit status. The commenters suggested that the Agency adopt the IRS antichurning rule standards that any person or entity that has an interest in the seller must have a less than 10 percent owner interest in the buyer.

*Response:* While the Agency acknowledges the commenters' concerns, it believes that there are sufficient numbers of nonprofit organizations that do not have an identity-of-interest relationship with borrowers of section 515 properties. The

prohibition on IOI relationships is statutory.

*Topic:* The Agency received several comments on the determination of minority impact. Some commenters asked for additional information on how the determination is made and clearer definitions of such terms as "market area," "adverse impact," and "housing opportunities for minorities." Several commenters indicated that this determination is of such importance that the standards for conducting this analysis should be included in the interim final rule instead of in the handbooks. Commenters also expressed concern that these determinations sometimes fail to correctly identify adverse impacts. Specifically, they stated that the Agency sometimes made incorrect assumptions about the need for the housing based on availability of section 8 housing, the lack of minorities in the property, or the size of the units. They suggested additional tools for the analysis, including the local section 8 wait list and a stronger definition of the term "market area." Finally, some commenters ventured that the standard creates a new barrier to prepayment and is virtually impossible to meet.

*Response:* The requirement regarding minority impact is statutory. While some commenters feel review criteria were too loose and others express concern that they will be too tight, the Agency strives to review relevant criteria in an objective manner. The Agency added language in § 3560.658(b) that describes the information that will be reviewed when the Agency makes this determination. The Agency agrees that "market area" needed a better definition and has added one to subpart A. Further the Agency agreed that "adverse impact" needed further clarification and has clarified that the adverse impact should be disproportionate. The Agency also felt that some clarification was needed for "housing opportunities for minorities." Therefore the Agency has clarified that an evaluation must be made of housing opportunities for minority tenants, applicants, and the market area in general. As to the suggestion of using local section 8 waiting lists in making these determinations, the Agency feels that this level of detail is unnecessary in its regulations. Additional details on how the Agency will review relevant information is available in Agency guidance about program procedures.

*Topic:* Several comments were received regarding the borrower's right to prepay. These commenters said that the Agency has no right to prohibit prepayment because the provisions of ELIPHA are no longer valid, and they

stressed the Agency's obligation to comply with the terms of their loan agreements. In addition, several commenters said that given the Agency chooses not to acknowledge the borrower's right to prepay, it should further streamline the prepayment process to assist in the preservation of affordable housing.

*Response:* The Agency's right to establish conditions for prepayment is statutory. The Agency has simplified the provisions throughout subpart N of the interim final rule to reduce the burden of preparing a prepayment application and retain only the requirements necessary to meet the statutorily required process.

*Topic:* The Agency received several comments stating that the rule does little to clarify or streamline the process and stressing the need for alternatives to the prepayment process. Commenters emphasized the importance of an efficient process to keep properties in the program and to facilitate the borrower's ability to bring new financing (such as tax credits) into the property. Some suggested revising specific timeframes for review and response. Others suggested creating separate tracks and alternative mechanisms for dealing with properties that meet certain conditions. For example, they suggested that the Agency create an expedited process for properties that are prepaying but remain subject to use restrictions because of another loan, for properties where the borrower preemptively rejects incentives, and for obsolete and high-vacancy properties. Several commenters stated there should be two tracks for preservation deals, one for prepayment without restrictions and another for prepayment with restrictions, and that the timelines for each should be 180 and 90 days, respectively. Others stated that the transfer process should be streamlined to facilitate transfers to nonprofit organizations and loan assumptions where the same rates and terms remain in place, which could alleviate some of the strain on the prepayment process by taking some properties out of that process. Finally, they suggested that the roles of the Preservation Office and the State Offices be clarified to avoid operational issues.

*Response:* The Agency has made many changes to reduce burden and simplify the process, in administrative practices, and both in the proposed rule and in the interim final rule, as the statute allows. The Agency has also streamlined the procedures for transfers and now allows for equity loans at the time of transfer in subpart I and encourages borrowers to take this route

in lieu of prepayment. In essence, these actions have now created two tracks for borrowers to follow to exit the program while preserving the affordable rental housing project. Otherwise the Agency has not adopted a separate track program nor a special process for nonprofits because the prepayment statute (42 U.S.C. 1472(c)) provides for a linear single track process. One of those tracks is within subpart I while the other is found in subpart N. Actions taken administratively have already reduced processing timeframes for most prepayments below the 180- and 90-day timeframes mentioned by the commenter. For example, offering general incentives has been a method the Agency has administratively implemented that greatly reduces processing time when a borrower indicates they have no desire to receive a specific incentive offer. Our discussion of the improvements made to the transfer process are detailed in our comments on subpart I including bringing new financing into the property.

*Topic:* Several commenters stated that the processing of prepayment requests takes more time than it should, and that the interim final rule should include an application processing timeline. They questioned the validity of the 180-day threshold for submitting a proposal given the process can take longer than that and also questioned the 180-day rule for restricted loans as these loans already stipulate timeframes in the loan documents. They also suggested adding a 30-day deadline for Agency review of the application.

*Response:* The Agency appreciates these comments and, as described in the Agency response to other public comments on subpart N, RHS has taken many steps to reduce burden, streamline the process and minimize delays. The 30-day tenant and nonprofit and public body notice and the 180-day advertisement period for sales to a nonprofit and public body are statutory (42 U.S.C. 1472(c)). Additional information on internal Agency processing timelines is included in Agency guidance about program procedures. The Agency has retained the 180-day period before an anticipated prepayment as a reasonable attempt to allow borrowers sufficient time to meet their plans for a payment date in light of the procedural steps and possible contingencies they may face. Of course the 180-day period is a minimum notice period and the borrower can provide earlier notice if they feel that it is required. The interim final rule significantly reduced the number of required components of a complete

application subject to review. This fact, by itself should greatly reduce the amount of time required by the Agency to review a prepayment application. However, the Agency has not adopted the suggestion for a 30-day review period because it considers this to be a matter of internal Agency procedure.

*Topic:* The Agency received numerous comments on the public notice requirements. While some commenters indicated that the lower burden on the Agency would be helpful to the overall process, others complained that the requirements shift the notice responsibility from the Agency to the borrower and that this is burdensome to the borrower. They stated that the notice to other Agencies should be an Agency responsibility. They also stated that there is no mechanism for maintaining the contact lists and that existing lists are incomplete, outdated, and include insufficient contact information. They suggested that the owner be permitted to select a nonprofit organization to sell to, without going through the notice requirements, subject to Agency approval of the buyer. They also suggested that public notice be made the Agency's responsibility instead of the borrower's.

*Response:* The Agency agrees with these comments and has adopted them into subpart N. Specifically, the Agency has developed a Web-based system, called the Prepayment Information Exchange (PIX), for providing electronic notices required during the prepayment process. PIX will also include a listing or nonprofit and public bodies that wish to be notified of prepayment requests or sales offers. The Agency also made changes to subpart N of the interim final rule that will permit the Agency to determine that no local nonprofits are available, to allow faster access to regional and national nonprofits.

*Topic:* The discussion of incentives generated significant numbers of comments. These comments fell into three major areas: (1) The availability of incentives, (2) the structure of incentives, and (3) the process for calculating incentives.

*Topic:* On the availability of incentives, commenters stressed the importance of providing promised incentives in a timely manner if the incentives are to be attractive to borrowers. They emphasized the need for sufficient budget and adherence to the timeframes in the processing timeline.

*Response:* The Agency recognizes the need for timely provision of incentives and has tried to reduce burden and streamline the process precisely for this

reason. The Agency also worked to open avenues to third party resources to provide funding for equity when a prepayment request has been filed. Agency guidance about program procedures outlines the Agency's procedures for adhering to established timeframes. The Agency is unable to control its budget.

*Topic:* Commenters also had a number of questions and comments about how incentives are structured: first, there was approval of the increased clarity on what the Agency can offer as incentives; however, this increased clarity inevitably raises new questions. One commenter asked if the Agency intends to retain both the specific and the general incentive offers. Several commenters asked why equity loans are capped at 90 percent. Some commenters asked that the Agency exercise flexibility with regard to exception rents where this is the most economically feasible approach to keeping a borrower in the program. And commenters had questions about the 50-year amortization period for 1 percent loans. Others proposed edits for clarity around such concepts as equity and investment.

*Response:* The Agency has developed detailed procedures for developing offers, which will be described in Agency guidance about program procedures. The general and specific incentive offer will be retained. The 90 percent limitation on equity loan incentives is statutory. The Agency has reserved the authority to exceed market rents and will follow procedural guidance on establishing the most valid amortization period. The Agency has developed these procedures with careful consideration to provide a fair incentive that assures adequate resources to borrowers so they can operate the properties in conformance with applicable property standards while meeting the Agency's statutory responsibility to retain affordable housing units. The Office of Rural Housing Preservation will work to coordinate preservation efforts so that processes are followed consistently and compatible guidance is developed as new issues emerge. The Agency adopted all edits which it felt added clarity to its prepayment process.

*Topic:* Commenters raised a number of questions about how the incentives are calculated. Some asked that if the Agency provides an increase in annual return on the investment, the increase should be included in the project's operating expense budget to ensure that the borrower actually receives the money. Others asked about the applicability of the 30-year Treasury rate and what to do in the absence of

such a rate. Some asked how to factor deferred maintenance into the determination of incentives. Others had questions about the statement that once established, incentive offers can not be renegotiated, though they can be changed. Still others had questions about the determination for equity loans that other incentives are not adequate.

*Response:* When the Agency develops an incentive, it commits to rents sufficient to fund the incentive. The 30-year Treasury rate has been changed to the 15-year Treasury rate. Further procedural guidance has been developed to clarify what the Agency interprets as deferred maintenance. Incentives are not renegotiated to preserve the integrity of the original commitment. These and other topics related to process rather than policy are described in Agency guidance about program procedures. The statute requires the Agency to determine that other incentives are not adequate to encourage an owner to accept additional restrictions prior to offering an equity loan. The Agency makes this determination based on its knowledge of the market and the borrowers' interests.

*Topic:* Commenters questioned when LOPEs would be used, given the prohibition on prepayment in properties where there is an adverse impact on tenants. Commenters also stated that LOPEs are not sufficient to guarantee housing in tight markets. Further, they asked why there was a time limit placed on tenants seeking LOPEs.

*Response:* The Agency expects that the LOPEs will be used in properties where prepayment is approved. The Agency recognizes that the LOPEs do not address all housing problems faced by tenants.

*Topic:* A number of commenters raised questions about the applicability of prepayment rules. One commenter observed that this subpart should specify that it does not apply to borrowers who make their last payment in accordance with their promissory note and amortization schedule. Another stated that the rule should allow for prepayment only in cases of payment in full as the current procedure does. And one commenter stated that all distressed properties should be eligible for prepayment incentive assistance, not simply those between 1979 and 1989.

*Response:* The Agency has made no changes to the eligibility for prepayment, or the incentives, as the statute establishes both. The statute does not distinguish between distressed or fully operational properties. Paying off a mortgage in accordance with the last scheduled payment at the end of the

loan's full amortization schedule does not constitute prepayment.

*Topic:* A few commenters suggested that the Office of Rental Housing Preservation (ORHP) adopt a broader strategy for preserving housing that addresses the long-term upkeep and rehabilitation of properties and the need to do this for funding and for new owners to achieve these goals. One commenter suggested a "recovery program" under which the ORHP would review and restructure financing on aging properties, working with for-profit and nonprofit developers who focus on troubled properties. Through this recovery effort, the ORHP would expedite transfers, prepayments, and loan workouts and would provide a subsidy clearinghouse for owners willing to take on troubled properties.

*Response:* The Agency appreciates these comments and is examining new ways to facilitate these actions including examining the issues surrounding the "recovery program" concept. Any procedural changes made are covered in Agency guidance about program procedures. Any changes in policy identified by the Agency will be addressed in subsequent rulemaking as needed and appropriate.

*Topic:* There were several comments on appeal rights. Some commenters questioned whether borrowers had the right to appeal the prepayment decisions. Others asked the tenants' rights to an appeal and suggested that notices provided to tenants should advise them of this right.

*Response:* The Agency notes that subpart A states that Agency decisions that may negatively affect an applicant or borrower may be appealed pursuant to 7 CFR part 11. Tenants have a right to file grievances in cases where owners do not fulfill their responsibilities under the program, as outlined in subpart D, however, they cannot file grievances in cases of displacement or other adverse actions as a result of loan prepayment.

*Topic:* One commenter asked if in § 3560.655 whether the Agency meant "expired restricted loan" or "expired restrictive-use provisions."

*Response:* The Agency did not find the reference, however, at § 3560.652, the Agency explicitly refers to "expired restrictive-use provisions."

*Topic:* Commenters suggested several minor editorial changes for clarity in the section on borrower rejection of the incentives and asked for more detail on the definition of the market area.

*Response:* The Agency has made several editorial changes to this section for clarity. Market area is now defined in subpart A of the interim final rule.

*Topic:* A commenter asked if the language in § 3560.659(e) inappropriately excludes new moderate-income residents from moving into a property that is in the process of accepting restrictions.

*Response:* Any moderate-income exclusion is prescribed by statute (42 U.S.C. 1472(c)(5)(B)). The moderate-income exclusion would only take effect if a nonprofit or public body buys the project and leaves the program.

*Topic:* Commenters had many questions about the process for selling to nonprofit organizations and public agencies. These comments focused on the advances, the selection of buyers, the sales process, and bona fide offers.

*Topic:* Commenters welcomed the provision for advances to nonprofit organizations but suggested that more money is needed to make these sales occur and asked for more information about how the advances will occur. They also suggested that in addition to the funds, technical assistance would be helpful to nonprofits.

*Response:* The Agency appreciates these comments and is striving to maximize the resources available to properties. The procedural guidance on how advances are requested and approved is covered in Agency guidance about program procedures. The Agency believes this guidance will be adequate and no significant change is anticipated from previous guidance provided in previous Agency instructions.

*Topic:* Several commenters had questions about the selection of the nonprofit buyer. Some asked for more information on how to contact nonprofit organizations. The language in § 3650.659(d) confused several commenters. They asked if the Agency is limiting nonprofit organizations to acquire, at most, one prepaid section 515 property. Other commenters asked for guidance on how to select among qualified nonprofits and asked that the rule specify that it is permissible to accept the highest acceptable offer.

*Response:* The Agency notes that § 3650.659(d) addresses identity-of-interest issues and does not limit the number of properties a nonprofit organization can acquire. The prohibition on the IOI between purchasing nonprofit or public body entities and entities that have prepaid a loan is statutory. The rule does address the selection between similar offers at § 3560.659(f).

*Topic:* Commenters also had questions on the sales process in general. They suggested edits to several parts of § 3560.659 for clarity. Commenters asked for more clarity on the information to be provided to

potential nonprofit buyers and offered some additional suggestions. Two commenters also asked that the rule specify some limits on the disclosure of information provided by the borrower to a prospective buyer.

*Response:* Section 3650.659 of the interim final rule describes the types of information to be made available so that potential purchasers understand the project's physical and operational status. The Agency guidance about program procedures provides specific examples and added clarity of what borrowers must release to potential nonprofit buyers to provide sufficient information to allow for an informed offer to purchase.

*Topic:* Commenters asked for a more extensive definition of a "bona fide" offer, for example, clarifying how committed an offerer's financing must be.

*Response:* No further guidance will be provided on whether an offer is bona fide in this rule. The Agency feels that sufficient guidance is already provided in the rule and also independently reviews this issue (for example see § 3560.659(e)(3)). However the Agency does want to note that in order to be a bona fide offer, the offer must be consistent with the appraised value established in accordance with § 3560.659(a). The Agency will subsequently provide additional guidance on the factors it will use to evaluate whether an offer is bona fide. Section 3650.659(k) of the interim final rule also establishes a 24-month timeframe for the completion of the transaction. Since this is a business transaction, the credibility of any sales transaction will not be established in a regulation but by the terms of the sales contract.

*Topic:* Commenters noted that all agreements currently reference 7 CFR part 1930, subpart C and will therefore need to be updated.

*Response:* The Agency appreciates these comments and has updated the references in the agreements.

#### **Subpart O—Unauthorized Assistance**

*Topic:* One commenter expressed concern that the focus of this subpart was solely on unauthorized assistance, and that the Agency also specifically should address cases where tenants receive "too little assistance" because they inadvertently over report their income or do not know the exclusions or deductions to which they are entitled.

*Response:* The Agency appreciates the concern and will consider this

suggestion as it updates its internal Agency procedures.

*Topic:* Another commenter noted that the proposed rule does not explicitly establish the policy that repayment plans need to be feasible given an tenant's capacity to pay.

*Response:* The Agency believes that § 3560.705(c) provides adequate guidance regarding this issue. No set structure is given intentionally, so flexibility is available depending on the tenant's situation. It should be noted, that the Agency is committed to collecting unauthorized assistance that was received by either the borrower or tenant.

*Topic:* Multiple commenters indicated that they did not see an explicit statement in the rule establishing that when tenants receive unauthorized assistance due to borrower error, the borrower may not seek to recover this unauthorized assistance from the tenant.

*Response:* The Agency acknowledges the comment, and notes that this was the Agency's intent in the proposed rule. RHS has revised the language in § 3560.708(d) to clarify this policy.

*Topic:* Several commenters addressed the topic of using project funds to pay for unauthorized assistance. Several commenters agreed with the language in the proposed rule prohibiting the use of project funds to pay for unauthorized assistance due to borrower error. Other commenters strongly disagreed, noting that because the program rules are complex, honest and/or inadvertent mistakes can occur. These commenters noted that in the cases of honest mistakes, the additional funds go to the project or the tenant, not to the manager or borrower. They requested that the Agency prohibit the use of project funds to repay unauthorized assistance only in cases of borrower fraud.

*Response:* The Agency agrees with the commenters that the prohibition on using project funds to repay unauthorized assistance should only apply to cases of borrower fraud. The Agency has made this change in § 3560.705(g).

*Topic:* Several commenters addressed the language in the proposed rule relieving borrowers of responsibility for seeking repayment of unauthorized assistance to tenants in cases when the tenant has moved out of the property. Numerous commenters agreed with this change, noting that borrowers have very little practical authority to compel tenants to repay such funds once they no longer live at the property. They also noted that the process of trying to pursue former tenants can often be difficult and time-consuming for staff,

and collection agencies may not always be a viable option. Other commenters strongly disagreed with the policy as presented in the proposed rule. They indicated that borrowers often have the best information about such persons and often have provided the information to a collection agency. These commenters expressed concern that relieving borrowers of this responsibility will only increase the burden on Rural Development staff who are not in as strong a position to collect these funds.

*Response:* The Agency acknowledges the concerns raised by commenters but has decided to retain the policy as described in the proposed rule because this policy gives RHS greater flexibility to apply resources cost-effectively toward the cases that most deserve to be pursued and reduces the burden on borrowers and projects. No changes to the regulation were made in response to these comments.

*Topic:* Multiple commenters expressed concern that some of the language in the subpart appeared to hold borrowers responsible for the acts of residents. The commenters agreed that borrowers have a responsibility to take action to identify and collect unauthorized assistance received by tenants but took the position that borrowers are not responsible for another party's fraud or misrepresentations of income.

*Response:* Borrowers must use due diligence in verifying tenant income. The Agency, however, acknowledges the concerns expressed by the commenters and has simplified and clarified the language in § 3560.708.

*Topic:* Multiple commenters expressed support for the use of offsets as an effective tool for collecting unauthorized assistance, and one commenter described how it and the Treasury's Cross-Servicing Program had worked well.

*Response:* The Agency appreciates these comments.

*Topic:* One commenter questioned the reference to 7 CFR 3550.210 regarding the use of offsets and asked whether a more appropriate reference would be to 7 CFR part 3.

*Response:* The Agency understands the question but has made no change because the reference to the Single Family Housing regulation is specific to housing programs.

*Topic:* Multiple commenters asked questions about procedures related to unauthorized assistance and enforcement referrals. Another commenter perceived inconsistencies between the proposed rule and the program handbooks.

*Response:* The Agency will describe how it intends to address unauthorized assistance and enforcement referrals when it updates its internal Agency procedures in conjunction with the issuance of the interim final rule.

*Topic:* One commenter suggested asking tenants to sign a document similar to an Applicant Certification related to Federal Collection Policies for Consumer or Commercial Debt at the time that they apply for occupancy as a possible way to further protect the government's interests.

*Response:* This form is not necessary to be completed by the tenant. The Tenant Certification form has been amended to provide adequate language to protect the government's interests.

### Subpart P—Appraisals

*Topic:* Several commenters asked the Agency to clarify the circumstances when the different types of appraisals identified in the regulation should be performed. In particular, multiple commenters asked that the regulation indicate that a "value-in-use" appraisal is needed when a project is receiving another type of housing assistance. Another commenter wanted clarification that an "as-improved" appraisal is needed when a project is being rehabilitated. Further, some commenters asked for clarification about the methods to be used in conducting the appraisals.

*Response:* The Agency has clarified the language in this subpart. In making the revisions, the Agency has used terminology that reflects current use within the appraisal industry in an effort to reduce the potential for confusion when a borrower or Rural Development requests an appraisal. Information about methods to be used when conducting appraisals will be provided in the program handbooks.

*Topic:* Multiple commenters expressed concern about the language in the proposed rule restricting the release of appraisals to borrowers.

*Response:* The Agency acknowledges the concern raised by the commenters and has revised § 3560.752(c) of the proposed rule (now § 3560.752(d) of the interim final rule) to allow the release of appraisals to borrowers or applicants upon their request.

*Topic:* One commenter expressed concern that the terms "security value" and "value-in-use" were not adequately defined.

*Response:* The Agency provides further clarification of the definition of "security value" in the handbooks. RHS has deleted the term "value-in-use" from the regulation and has included

the term "market value, subject to restricted rents", along with a definition, in this subpart. The latter term will be more readily understood by appraisers and users of appraisals.

*Topic:* One commenter expressed concern that the language in this subpart contradicts the definition of current appraisal in subpart A.

*Response:* The Agency has made the language consistent with the subpart A definition.

*Topic:* One commenter expressed concern about using appraisals that are more than 12 months old if there is mutual agreement between the Agency and the borrower or applicant because this allowance could be abused.

*Response:* An exception to the use of a current appraisal if the Agency and the applicant or borrower mutually agree to the use of an appraisal that is not current is considered by the Agency a prudent policy that allows for flexibility in individual cases that warrant it. It is unlikely that this policy could be abused if the Agency and the applicant, or borrower, both agree to it. Therefore, no change has been made based on this comment.

*Topic:* One commenter stated that § 3560.753 implied that appraisers had to be members of a professional organization to do appraisals, which conflicts with State licensing laws.

*Response:* The Agency did not intend that membership in a professional organization is a qualification requirement for appraisers to write appraisals for the Agency. The Agency revised paragraph (b) of this section to clarify that MFH appraisals prepared for the Agency will be written by Agency appraisers or independent fee appraisers who are State-certified general appraisers, certified or licensed in the state where the property is located.

*Topic:* One commenter requested that the proposed rule include a statement on due diligence and that due diligence be conducted in accordance with American Society for Testing and Materials standards.

*Response:* Agency appraisal procedures concerning environmental issues that might impact value simply clarify established regulatory requirements and are being provided in the updated internal Agency procedures being prepared in conjunction with the issuance of the interim final rule.

*Topic:* One commenter questioned whether the phrase "consummation of a sale as of a specified date" in § 3560.752 is inconsistent with the sale to a nonprofit organization under subpart N.

*Response:* The Agency has made no change based on this comment because the phrase "consummation of a sale as

of a specified date” is part of the most commonly used definition of “market value” used in the appraisal industry. The phrase is an essential part of the definition and is not inconsistent with sale procedures under subpart N.

*Topic:* One commenter expressed concern that subpart P uses terms and language that are inconsistent with the Uniform Standards of Professional Appraisal Practice (USPAP) and appraisal literature in general.

*Response:* The Agency has made minor wording changes throughout the subpart as suggested to be consistent with USPAP.

*Topic:* One commenter suggested that the Agency’s handbook language regarding appraisals could be a guide for the regulation.

*Response:* The Agency agrees with the commenter. Updated Agency internal procedures being issued in conjunction with the interim final rule will clarify procedures for satisfying the requirements established by this subpart.

**Discussion of Comments—Proposed Rule Regarding Operating Assistance for Off-Farm Migrant Farmworker Projects**

The proposed rule was published in the **Federal Register** on November 2, 2000 (65 FR 65790), with a 60-day comment period that ended January 2, 2001. Four comments were received about the language in the proposed rule.

The public comments about the proposed rule are discussed below. The regulatory provisions of operating assistance for Off-Farm Labor Housing projects are now addressed in 7 CFR part 3560, subpart L. RHS sincerely appreciates the time and effort of all commenters.

*Topic:* Several commenters noted that Pub. L. 106–569 had been enacted since the publication of the proposed rule, and suggested that the rule be revised to include the provisions from this statute allowing the use of section 521 funds as an operating subsidy in Off-Farm Labor Housing projects that house both migrant and year-round farmworkers.

*Response:* The Agency agreed with the commenters and incorporated the provisions of Pub. L. 106–569 allowing the use of section 521 as an operating subsidy in Off-Farm Labor Housing projects that house both migrant and year-round farmworkers in § 3560.575(a) of the interim final rule.

*Topic:* Multiple commenters expressed concern that in some cases MTFFS data will not exist and suggested that the regulations allow alternative methods for establishing prevailing migrant farmworker incomes and the amount of income from farmwork.

*Response:* The Agency agreed with the commenters. Neither the proposed rule nor the final rule mandated the use of MTFFS data. Owners may utilize other reliable data to establish the average adjusted monthly household income of migrant farmworker households in the area.

*Topic:* One commenter stated that 30 percent of a migrant worker’s income is more than a worker can afford for rent because most migrant workers also have to bear the cost of housing at their home base as well. This commenter suggested that 20 percent is a more reasonable portion of a migrant farmworker’s income to be used for housing.

*Response:* The Agency acknowledges the commenter’s concern and considered the suggestion. However, the Agency retained 30 percent as the standard for the amount of income occupants of such housing are able to pay toward shelter costs in § 3560.574 (c)(1) of the interim final rule. The Agency retained this standard because it enables the program to serve more farmworkers with the available funds, while keeping the amount that tenants must pay for shelter reasonable by the standard used in many other affordable housing programs, such as the section 515 program. Further, the Agency retained this standard to keep it consistent with the standard used in the Agency’s section 515 rental housing program.

*Topic:* One commenter suggested that operating assistance be paid in a single annual payment, instead of the

proposed equal monthly payments. The commenter observed that during the peak operating season cash demands are higher and that monthly payments could cause cash flow problems for properties during the peak season.

*Response:* The Agency acknowledges the commenter’s concern and considered the suggestion. However, the Agency retained the monthly payment provision in § 3560.574(c)(3) of the interim final rule. The Agency acknowledges that cash flow may vary during the year, however, it believes that these fluctuations should not be a problem for borrowers operating such projects. Existing projects should be fiscally sound and have adequate operating reserves to cover any short-term operating deficiencies. Further, new projects are required to have a two percent operating reserve to offset any short-term cash deficiencies.

*Topic:* One commenter noted that since operating assistance payments are estimated, there should be a mechanism for adjusting the actual assistance payments if estimates are incorrect.

*Response:* The Agency agrees with the commenter’s remark. The Agency notes that the provision for annual adjustments was contained in the proposed rule at § 1944.182(b)(3) and is included in the interim final rule. In § 3560.574(a) of the interim final rule, the Agency established that the amount of operating assistance payments is determined each year based on the project’s budget, and may not exceed 90 percent of the annual operating costs attributable to the migrant units. The Agency notes that if the payments for the previous year resulted in a shortfall or a surplus, these circumstances can be addressed in the budget for the coming year, and consequently in the operating assistance payment amounts for the coming year.

**Regulatory Crosswalk**

The following is a crosswalk that shows where the content of the 14 regulations that have been consolidated can be found in 7 CFR part 3560.

Topic	Previous location	Location in:	
		7 CFR part 3560	Handbooks
<b>General Provisions and Definitions:</b>	<b>Numerous Instructions:</b>	<b>Subpart A:</b>	<b>All Three Handbooks:</b>
Civil rights .....	7 CFR part 1901, subpart E .....	§ 3560.2 .....	Loan Origination Chapters 1 & 3, Asset Management Chapter 1, Project Servicing Chapter 1.
State, local, or tribal laws .....	7 CFR 1930.105(b)(6); 7 CFR 1944.53(c)(1); 7 CFR 1944.164(e)(2)(ii); 7 CFR 1944.169(c)(3); 7 CFR 1944.224(d).	§ 3560.5 .....	Loan Origination Chapter 1, Asset Management Chapter 1, Project Servicing Chapter 1.

Topic	Previous location	Location in:	
		7 CFR part 3560	Handbooks
Borrower responsibility and requirements.	7 CFR 1944.211(b); 7 CFR 1930.101; 7 CFR part 1930, subpart C, Exhibit B, Para. III.	§ 3560.6 .....	Loan Origination Chapters 3–13, Asset Management Chapters 3–9, Project Servicing Chapters 4–15.
Administrator's exception authority.	7 CFR 1930.144 .....	§ 3560.8 .....	Loan Origination Chapter 1, Asset Management Chapter 1, Project Servicing Chapter 1.
Definitions .....	All regulations listed under "Implementation Proposal".	§ 3560.11 .....	Loan Origination, Asset Management, Project Servicing, Throughout all three.
<b>Direct Loan and Grant Origination:</b>	<b>7 CFR Part 1944, Subpart E:</b>	<b>Subpart B:</b>	<b>Loan Origination:</b>
Eligible use of funds .....	7 CFR 1944.212 .....	§ 3560.53 .....	Loan Origination, Chapter 4.
Processing Section 515 housing proposals.	7 CFR 1944.231 .....	§ 3560.56 .....	Loan Origination, Chapter 4.
Initial operating capital contribution.	7 CFR 1944.211(a)(6) .....	§ 3560.64 .....	Loan Origination, Chapter 4.
Reserve account .....	7 CFR part 1944, subpart E, Exhibit A–9, Para. 10.b.	§ 3560.65 .....	Loan Origination, Chapter 4.
Participation with other funding or financing sources.	7 CFR 1944.233 .....	§ 3560.66 .....	Loan Origination, Chapter 4.
Rates and terms for section 515 loans.	7 CFR 1944.214 .....	§ 3560.67 .....	Loan Origination, Chapter 5.
Permitted return on investment (ROI).	7 CFR 1944.215(n) .....	§ 3560.68 .....	Loan Origination, Chapter 5.
Supplemental requirements for congregate housing and group homes.	7 CFR 1944.224 .....	§ 3560.69 .....	Loan Origination, Chapter 11.
Subsequent loans .....	7 CFR 1944.237 .....	§ 3560.73 .....	Loan Origination, Chapter 10.
<b>Borrower Management and Operations Responsibilities:</b>	<b>7 CFR Part 1930, Subpart C, Exhibit B:</b>	<b>Subpart C:</b>	<b>Asset Management:</b>
Housing project management ....	7 CFR part 1930, subpart C, Exhibit B, Para. V.	§ 3560.102 .....	Asset Management, Chapter 3.
Maintaining housing projects .....	7 CFR part 1930, subpart C, Exhibit B, Para. X.	§ 3560.103 .....	Asset Management, Chapter 5.
Fair housing .....	7 CFR 1930.103 and 104, 7 CFR Part 1930, Subpart C, Exhibit B, Para. VI.	§ 3560.104 .....	Chapter 1 in all 3 Handbooks Asset Management Chapter 6.
Insurance and taxes .....	7 CFR part 1930 subpart C, Exhibit B, Para. XV.	§ 3560.105 .....	Asset Management Chapter 3.
<b>Multi-Family Housing Occupancy:</b>	<b>7 CFR Part 1930, Subpart C, Exhibit B:</b>	<b>Subpart D:</b>	<b>Asset Management:</b>
Tenant eligibility .....	7 CFR part 1930, subpart C, Exhibit B, Para. VI.	§ 3560.152 .....	Asset Management Chapter 6.
Calculation of household income and assets.	7 CFR part 1930, subpart C, Exhibit B, Para. VII.	§ 3560.153 .....	Asset Management Chapter 6.
Tenant selection .....	7 CFR part 1930, subpart C, Exhibit B, Para. VI.	§ 3560.154 .....	Asset Management Chapter 6.
Assignment of rental units and occupancy policies.	7 CFR part 1930, subpart C, Exhibit B, Para. VI.	§ 3560.155 .....	Asset Management Chapter 6.
Lease requirements .....	7 CFR part 1930, subpart C, Exhibit B, Para. VIII.	§ 3560.156 .....	Asset Management Chapter 6.
Occupancy rules .....	7 CFR part 1930, subpart C, Exhibit B, Para. VIII.	§ 3560.157 .....	Asset Management Chapter 6.
Changes in tenant eligibility .....	7 CFR part 1930, subpart C, Exhibit B, Para. VI.	§ 3560.158 .....	Asset Management Chapter 6.
Termination of occupancy .....	7 CFR part 1930, subpart C, Exhibit B, Para. XIV.	§ 3560.159 .....	Asset Management Chapter 6.
Tenant grievances .....	7 CFR part 1944, subpart L .....	§ 3560.160 .....	Asset Management Chapter 6.
<b>Rents:</b>	<b>7 CFR Part 1930, Subparts B and C:</b>	<b>Subpart E:</b>	<b>Asset Management:</b>
Establishing rents and utility allowances.	7 CFR part 1930, subpart C, Exhibit C.	§ 3560.202 .....	Asset Management Chapter 7.
Tenant contributions .....	7 CFR part 1930, subpart C, Exhibit B, Para. II.	§ 3560.203 .....	Asset Management Chapter 7.
Security deposits and membership fees.	7 CFR part 1930, subpart C, Exhibit B, Para. VIII H.	§ 3560.204 .....	Asset Management Chapter 7.
Rent and utility allowance changes	7 CFR part 1930, subpart C, Exhibit C.	§ 3560.205 .....	Asset Management Chapter 7.
Rents during eviction or failure to recertify.	7 CFR part 1930, subpart C, Exhibit B, Para. XIV.A.	§ 3560.208 .....	Asset Management Chapter 7.

Topic	Previous location	Location in:	
		7 CFR part 3560	Handbooks
Special note rents (SNRs) .....	7 CFR part 1930, subpart C, Exhibit C, Para. IX.	§ 3560.210 .....	Asset Management Chapter 7.
<b>Rental Subsidies:</b>	<b>7 CFR Part 1930, Subpart C, Exhibit E :</b>	<b>Subpart F:</b>	<b>Asset Management:</b>
Authorized rental subsidies .....	7 CFR part 1930, subpart C, Exhibit E, Para. II.	§ 3560.252 .....	Asset Management Chapter 8.
Eligibility for rental assistance ....	7 CFR part 1930, subpart C, Exhibit E, Para. II. A.	§ 3560.254 .....	Asset Management Chapter 8.
Rental assistance payments .....	7 CFR part 1930, subpart C, Exhibit E, Para. X.	§ 3560.256 .....	Asset Management Chapter 8.
Assigning rental assistance .....	7 CFR part 1930, subpart C, Exhibit E, Para. XI.	§ 3560.257 .....	Asset Management Chapter 8.
Rental subsidies from non-Agency sources.	7 CFR part 1930, subpart C, Exhibit B, Paras. IV. C, D, and E.	§ 3560.260 .....	Asset Management Chapter 8
<b>Financial Management:</b>	<b>7 CFR Part 1930, Subpart C, Exhibit B:</b>	<b>Subpart G:</b>	<b>Asset Management:</b>
Accounting, bookkeeping, budgeting, and financial management systems.	7 CFR 1930.122, 7 CFR part 1930, subpart C, Exhibit B, Para. XIII.	§ 3560.302 .....	Asset Management Chapter 4.
Housing project budgets .....	7 CFR part 1930, subpart C, Exhibit B, Para. XII.A.	§ 3560.303 .....	Asset Management Chapter 4.
Initial operating capital .....	7 CFR part 1930, subpart C, Exhibit B, Para. XIII.B.2.a.(1).	§ 3560.304 .....	Asset Management Chapter 4.
Return on investment .....	7 CFR part 1930, subpart C, Exhibit B, Para. XII.A.8.	§ 3560.305 .....	Asset Management Chapter 4.
Reserve account .....	7 CFR part 1930, subpart C, Exhibit B, Para. XIII.B.2.c.	§ 3560.306 .....	Asset Management Chapter 4.
Annual financial reports .....	7 CFR 1930.122(b)(4); 7 CFR part 1930, subpart C, Exhibit A-1.	§ 3560.308 .....	Asset Management Chapter 4.
<b>Agency Monitoring:</b>	<b>7 CFR Part 1930, Subpart C:</b>	<b>Subpart H:</b>	<b>Asset Management:</b>
Agency monitoring scope, purpose, and borrower responsibilities.	7 CFR 1930.109, 110, 113, 117 ..	§ 3560.352 .....	Asset Management Chapter 9.
Scheduling of on-site monitoring reviews.	7 CFR 1930.119(d) .....	§ 3560.353 .....	Asset Management Chapter 9
Borrower response to monitoring review notifications.	7 CFR 1930.119(f) .....	§ 3560.354 .....	Asset Management Chapter 9.
<b>Servicing:</b>	<b>7 CFR Part 1951, Subpart A and 7 CFR Part 1965, Subpart B:</b>	<b>Subpart I:</b>	<b>Project Servicing:</b>
Account servicing .....	7 CFR part 1951, subpart A .....	§ 3560.403 .....	Project Servicing Chapter 4.
Final loan payments .....	7 CFR part 1951, subpart D .....	§ 3560.404 .....	Project Servicing Chapter 4.
Borrower organizational structure or ownership interest changes.	7 CFR 1965.63 .....	§ 3560.405 .....	Project Servicing Chapter 5.
Multi-family housing ownership transfers or sales.	7 CFR 1965.65 .....	§ 3560.406 .....	Project Servicing Chapter 7
Subordinations or junior liens against security property.	7 CFR 1965.83 .....	§ 3560.409 .....	Project Servicing Chapter 8.
Consolidations .....	7 CFR 1965.68 .....	§ 3560.410 .....	Project Servicing Chapter 11.
<b>Special Servicing, Enforcement, Liquidation, and Other Actions:</b>	<b>Numerous Instructions:</b>	<b>Subpart J:</b>	<b>Project Servicing:</b>
Monetary and non-monetary defaults.	7 CFR 1955.15(d)(2) .....	§ 3560.452 .....	Project Servicing Chapter 10
Workout agreements .....	7 CFR part 1965, subpart B, Exhibit B.	§ 3560.453 .....	Project Servicing Chapter 10.
Special servicing actions related to housing operations.	7 CFR part 1930, subpart C, Exhibit C, Para. IX.	§ 3560.454 .....	Project Servicing Chapter 10
Special servicing actions related to loan accounts.	7 CFR 1965.85 .....	§ 3560.455 .....	Project Servicing Chapter 10.
Liquidation .....	7 CFR part 1955, subpart A .....	§ 3560.456 .....	Project Servicing Chapter 12
Negotiated debt settlement .....	7 CFR 1956.57(c) .....	§ 3560.457 .....	Project Servicing Chapter 12.
<b>Management and Disposition of Real Estate Owned (REO) Properties:</b>	<b>7 CFR Part 1955, Subparts B and C:</b>	<b>Subpart K:</b>	<b>Project Servicing:</b>
Conversion of single family type REO property to multi-family housing use.	7 CFR 1955.114(c) .....	§ 3560.506 .....	Project Servicing Chapter 14.

Topic	Previous location	Location in:	
		7 CFR part 3560	Handbooks
<b>Off-Farm Labor Housing:</b>	<b>7 CFR Part 1944, Subpart D:</b>	<b>Subpart L:</b>	<b>Loan Origination:</b>
Eligibility requirements for off-farm labor housing loans and grants.	7 CFR 1944.157 .....	§ 3560.555 .....	Loan Origination Chapter 13.
Design and construction requirements.	7 CFR part 1944, subpart D, Exhibit A-3.	§ 3560.559 .....	Loan Origination Chapters 3 & 13.
Loan and grant limits .....	7 CFR 1944.164 .....	§ 3560.562 .....	Loan Origination Chapters 5 & 13.
Participation with other funding or financing sources.	7 CFR 1944.163 .....	§ 3560.565 .....	Loan Origination Chapters 6 & 12.
Loan and grant rates and terms	7 CFR 1944.159 .....	§ 3560.566 .....	Loan Origination Chapters 5 & 13.
Supplemental requirements for seasonal off-farm labor housing.	7 CFR 1944.163(e) .....	§ 3560.568 .....	Loan Origination Chapter 13.
Rental assistance .....	7 CFR 1944.182 .....	§ 3560.573 .....	Loan Origination Chapters 4 & 13, Asset Management Chapter 8.
Occupancy restrictions .....	7 CFR 1944.154 .....	§ 3560.576 .....	Loan Origination Chapter 13, Asset Management Chapter 6.
Tenant priorities for labor housing.	7 CFR 1944.154 .....	§ 3560.577 .....	Loan Origination Chapter 13, Asset Management Chapter 6.
<b>On-Farm Labor Housing:</b>	<b>7 CFR Part 1944, Subpart D:</b>	<b>Subpart M:</b>	<b>Loan Servicing:</b>
Eligibility requirements .....	7 CFR 1944.157 .....	§ 3560.605 .....	Loan Origination Chapter 13.
Site and construction requirements.	7 CFR part 1944, subpart D, Exhibit A-3.	§ 3560.608 .....	Loan Origination Chapters 3 & 13.
Loan limits .....	7 CFR 1944.164 .....	§ 3560.612 .....	Loan Origination Chapters 5 & 13.
Reserve accounts .....	7 CFR part 1944, subpart E, Exhibit A-9, Para. 10.b.	§ 3560.614 .....	Loan Origination Chapters 4 & 13.
Participation with other funding sources.	7 CFR 1944.163 .....	§ 3560.615 .....	Loan Origination Chapters 6 & 13.
Rates and terms .....	7 CFR 1944.159 .....	§ 3560.616 .....	Loan Origination Chapters 5 & 13.
Supplemental requirements for on-farm labor housing.	7 CFR 1944.163(e) .....	§ 3560.618 .....	Loan Origination Chapter 13.
Housing management and operations.	7 CFR part 1944, subpart D, Exhibit B.	§ 3560.623 .....	Loan Origination Chapters 13, Asset Management Chapter 3.
Occupancy restrictions .....	7 CFR 1944.154 .....	§ 3560.624 .....	Loan Origination Chapters 13, Asset Management Chapter 6.
<b>Housing Preservation:</b>	<b>7 CFR Part 1965, Subpart E:</b>	<b>Subpart N:</b>	<b>Project Servicing:</b>
Prepayment and restrictive-use categories.	7 CFR 1965.208 and 209 .....	§ 3560.652 .....	Project Servicing Chapter 15.
Prepayment requests .....	7 CFR 1965.205 .....	§ 3560.653 .....	Project Servicing Chapter 15.
Tenant notification requirements	7 CFR 1965.206(b)(5) and (b)(6); 7 CFR 1965.215(e)(3) and (f)(2).	§ 3560.654 .....	Project Servicing Chapter 15.
Agency requested extension .....	7 CFR 1965.215(f)(2) .....	§ 3560.655 .....	Project Servicing Chapter 15.
Incentive offers .....	7 CFR 1965.213 .....	§ 3560.656 .....	Project Servicing Chapter 15.
Processing and closing incentive offers.	7 CFR 1965.214 .....	§ 3560.657 .....	Project Servicing Chapter 15.
Borrower rejection of incentive offer.	7 CFR 1965.214(b) .....	§ 3560.658 .....	Project Servicing Chapter 15.
Sale or transfer to nonprofit organizations and public bodies.	7 CFR 1965.217 .....	§ 3560.659 .....	Project Servicing Chapter 15.
Acceptance of prepayments .....	7 CFR 1965.215 .....	§ 3560.660 .....	Project Servicing Chapter 15.
<b>Unauthorized Assistance:</b>	<b>7 CFR Part 1951, Subpart N:</b>	<b>Subpart O:</b>	<b>Project Servicing:</b>
Identification of unauthorized assistance.	7 CFR 1951.656 .....	§ 3560.703 .....	Project Servicing Chapter 9.
Unauthorized assistance determination notice.	7 CFR 1951.657 .....	§ 3560.704 .....	Project Servicing Chapter 9.
Recapture of unauthorized assistance.	7 CFR 1951.658 .....	§ 3560.705 .....	Project Servicing Chapter 9.
Program participation and corrective actions.	7 CFR 1951.658(b) .....	§ 3560.707 .....	Project Servicing Chapter 9.
Unauthorized assistance received by tenants.	7 CFR 1951.661(a)(3) .....	§ 3560.708 .....	Project Servicing Chapter 9.
Demand letter .....	7 CFR 1951.658(c) .....	§ 3560.709 .....	Project Servicing Chapter 9.
<b>Appraisals:</b>	<b>7 CFR Part 1922, Subpart B:</b>	<b>Subpart P:</b>	<b>Project Servicing:</b>
Appraisal use, request, review, and release.	7 CFR 1922.52 .....	§ 3560.752 .....	Loan Origination Chapter 7, Project Servicing Chapter 8.
Agency appraisal standards and requirements.	7 CFR part 1922, subpart B, Exhibit A.	§ 3560.753 .....	Loan Origination Chapter 7, Project Servicing Chapter 7.

**List of Subjects****7 CFR Part 1806**

Buildings, Community development, Disaster assistance, Flood plains, Housing, Insurance, Loan programs—Agriculture, Loan programs—Housing and community development, Real property insurance, Rural areas.

**7 CFR Part 1822**

Loan programs—Housing and community development, Low and moderate income housing, Mortgages, Nonprofit organizations, Rural housing.

**7 CFR Part 1902**

Accounting, Banking, Grant programs—Housing and community development, Loan programs—Agriculture, Loan programs—Housing and community development.

**7 CFR Part 1925**

Real property taxes, Taxes.

**7 CFR Part 1930**

Accounting, Administrative practice and procedure, Grant programs—Housing and community development, Loan programs—Housing and community development, Low and moderate income housing, Reporting and recordkeeping requirements.

**7 CFR Part 1940**

Administrative practice and procedure, Agriculture, Allocations, Grant programs—Housing and community development, Loan programs—Agriculture, Rural areas

**7 CFR Part 1942**

Community development, Community facilities, Loan programs—Housing and community development, Loan security, Rural areas, Waste treatment and disposal—Domestic, Water supply—Domestic.

**7 CFR Part 1944**

Administrative practice and procedure, Aged, Farm labor housing, Grant programs—Housing and community development, Handicapped, Home improvement, Loan programs—Housing and community development, Low and moderate income housing—Rental, Migrant labor, Mobile homes, Mortgages, Nonprofit organizations, Public housing, Rent subsidies, Reporting requirements, Rural housing, Subsidies.

**7 CFR Part 1951**

Accounting, Accounting servicing, Credit, Debt restructuring, Grant programs—Housing and community development, Loan programs—Agriculture, Loan programs—Housing

and community development, Low and moderate income housing loans—Servicing, Mortgages, Rent subsidies, Reporting requirements, Rural areas.

**7 CFR Part 1955**

Foreclosure, Government acquired property, Government property management.

**7 CFR Part 1956**

Accounting, Loan programs—Agriculture, Rural areas.

**7 CFR Part 1965**

Administrative practice and procedure.

**7 CFR Part 3560**

Accounting, Administrative practice and procedure, Aged, Conflict of interests, Government property management, Grant programs—Housing and community development, Insurance, Loan programs—Agriculture, Loan programs—Housing and community development, Low and moderate income housing, Migrant labor, Mortgages, Nonprofit organizations, Public housing, Rent subsidies, Reporting and recordkeeping requirements, Rural areas.

**7 CFR Part 3565**

Banks, Civil rights, Credit, Guaranteed loans, Low and moderate income housing, Mortgages.

■ Therefore, Chapters XVIII and XXXV, title 7, Code of Federal Regulations are amended as follows:

**Chapter XVIII—[Amended]****PART 1806—INSURANCE**

■ 1. The authority citation for part 1806 continues to read as follows:

**Authority:** 75 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

**Subpart A—Real Property Insurance****§ 1806.4 [Amended]**

■ 2. Section 1806.4 is amended in the introductory text of paragraph (a)(2) by removing the sentence after the paragraph heading.

**Subpart B—National Flood Insurance**

■ 3. Section 1806.21 is amended in paragraph (a) by adding a sentence at the end of the paragraph to read as follows:

**§ 1806.21 General.**

(a) \* \* \* This subpart does not apply to the Rural Rental Housing, Rural Cooperative Housing, or Farm Labor Housing programs of the Rural Housing Service.

\* \* \* \* \*

**PART 1822—RURAL HOUSING LOANS AND GRANTS**

■ 4. The authority citation for part 1822 is revised to read as follows:

**Authority:** 5 U.S.C. 301; 42 U.S.C. 1480.

**Subpart G—Rural Housing Site Loan Policies, Procedures, and Authorizations****§ 1822.271 [Amended]**

■ 5. Section 1822.271 is amended:

■ a. In the table in paragraph (e) by removing the entire entry for “Form FmHA or its successor agency under Public Law 103–354 1944–50” and by revising the form number “1944–51” to read “3560–51” in the last entry of the table.

■ b. In paragraph (g), in the second sentence of the introductory text, by removing the words “and submit to the FmHA or its successor agency under Public Law 103–354 Finance Office through field office terminals that information contained in Form FmHA or its successor agency under Public Law 103–354 1944–50, ‘Multiple Family Housing Borrower/Project Characteristics.’”

■ c. By revising paragraph (d)(1) to read as follows:

**§ 1822.271 Processing applications.**

\* \* \* \* \*

(d) \* \* \*

(1) *Request for obligation of funds and fund analysis.* Form RD 3560–51, “Multiple Family Housing Obligation Fund Analysis” will be completed in accordance with the Forms Manual Insert (FMI).

\* \* \* \* \*

■ 6. Section 1822.272 is revised to read as follows:

**§ 1822.272 Approval or disapproval of a loan.**

The provisions of 7 CFR part 3560, subpart B will be followed.

■ 7. Section 1822.273 is revised to read as follows:

**§ 1822.273 Actions subsequent to loan approval.**

After the loan is approved, actions to be taken will be in accordance with 7 CFR part 3560, subpart B.

**§ 1822.274 [Amended]**

■ 8. Section 1822.274 is amended by revising the words “Form FmHA or its successor agency under Public Law 103–354 1944–52” to read “Form RD 3560–52” in both the introductory text of paragraph (c) and in paragraph (c)(2), and by revising the words “Form FmHA or its successor agency under Public Law

103-354 1944-51" to read "Form RD 3560-51" in paragraph (c)(1).

§ 1822.277 [Amended]

■ 9. Section 1822.277 is amended by revising the words "§ 1944.239 of part 1944, subpart E of this chapter" to read "7 CFR 3560.2."

§ 1822.278 [Amended]

■ 10. Section 1822.278 is amended in paragraph (f) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-52" to read "Form RD 3560-52."

■ 11. Section 1822.279 is revised to read as follows:

§ 1822.279 Loan supervision and servicing.

Loan supervision and loan servicing will be provided according to 7 CFR part 3560.

PART 1902—SUPERVISED BANK ACCOUNTS

■ 12. The authority citation for part 1902 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 7 U.S.C. 6991, et seq.; 42 U.S.C. 1480; Reorganization Plan No. 2 of 1953 (5 U.S.C. App.).

Subpart A—Disbursement of Loan, Grant, and Other Funds

§ 1902.1 [Amended]

■ 13. Section 1902.1 is amended in paragraph (a) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-51" to read "Form RD 3560-51" in both places.

§ 1902.2 [Amended]

■ 14. Section 1902.2 is amended in paragraph (d) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-51" to read "Form RD 3560-51" and in paragraph (e) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-53" to read "Form RD 3560-53."

§ 1902.4 [Amended]

■ 15. Section 1902.4 is amended:
■ a. In paragraph (a)(4) by revising the words "subpart C of part 1930 of this chapter" to read "7 CFR part 3560, subpart G."
■ b. In paragraph (a)(5) by revising the words "subpart C of part 1930 of this chapter" to read "7 CFR part 3560, subpart G."
■ c. In paragraph (a)(6) by revising the words "subpart C of part 1930 of this chapter" to read "7 CFR part 3560, subpart G."

PART 1925—TAXES

■ 16. The authority citation for part 1925 is revised to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart A—Real Estate Tax Servicing

■ 17. Section 1925.3 is amended by revising the last sentence in paragraph (c) to read as follows:

§ 1925.3 Servicing taxes.

(c) \* \* \* The Multi-Family Housing Information System (MFIS) will be used in posting servicing actions on delinquent taxes.

PART 1930—GENERAL

■ 18. The authority citation for part 1930 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 16 U.S.C. 1005.

Subpart C—Management and Supervision of Multiple Family Housing Borrowers and Grant Recipients

■ 19. Subpart C (§§ 1930.1930.101 through 1930.150 and all exhibits) is removed and reserved.

PART 1940—GENERAL

■ 20. The authority citation for part 1940 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

Subpart L—Methodology and Formulas for Allocation of Loan and Grant Program Funds

■ 21. Exhibit B to subpart L of part 1940 is amended by revising paragraphs IV., VII.A., and VII.F. to read as follows:

Exhibit B to Subpart L of Part 1940—Section 515 Nonprofit Set Aside (NPSA)

IV. Nondiscrimination. Rural Development reemphasizes the nondiscrimination in use and occupancy and location requirements of 7 CFR 3560.104.

VII. \* \* \*
A. Preapplications/applications for assistance from eligible nonprofit entities under this subpart must continue to meet all loan making requirements of 7 CFR part 3560, subpart B.

F. Provisions for providing preference to loan requests from nonprofit organizations is contained in 7 CFR 3560.56. Limited partnerships, with a nonprofit general

partner, do not qualify for nonprofit preference.

PART 1942—ASSOCIATIONS

■ 22. The authority citation for part 1942 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989.

Subpart A—Community Facility Loans

§ 1942.17 [Amended]

■ 23. Section 1942.17 is amended by removing paragraph (q)(1)(iii) and redesignating paragraph (q)(1)(iv) as (q)(1)(iii).

PART 1944—HOUSING

■ 24. The authority citation for part 1944 continues to read as follows:

Authority: 5 U.S.C. 301; 42 U.S.C. 1480.

Subpart B—Housing Application Packaging Grants

■ 25. Exhibit B to subpart B of part 1944 is amended by revising paragraph II.(B)(4) to read as follows:

Exhibit B to Subpart B of Part 1944—Housing Application Packaging Grant (HAPG) Fee Processing

II. \* \* \*
(B) \* \* \*
(4) The 55 percent balance paid when the loan is approved. Funds for this 55 percent will be drawn from loan funds in accordance with 7 CFR 3560.53 (o).

■ 26. Exhibit C to subpart B of part 1944 is revised to read as follows:

Exhibit C to Subpart B of Part 1944—Requirements for Housing Application Packages

A package will consist of the following requirements for the respective program.
A. Section 502—Complete application packages will be submitted in accordance with the requirements of 7 CFR part 3550. The package must also include the following: Form RD 410-9—"Statement Required by the Privacy Act"
Form RD 1910-11—"Applicant Certification Federal Collection Policies for Consumer or Commercial Debts"
Form RD 1944-3—"Budget and/or Financial Statement"
B. Section 504—Complete application packages will be submitted in accordance with 7 CFR part 3550. The package must include the forms listed in paragraph A. of this exhibit and the following:
The appropriate Agency application form for Rural Housing assistance (non-farm tract) (available in any Rural Development office).
The appropriate Agency form to request verification of employment (available in any Rural Development office).

The appropriate Agency Rural Housing Loan application package (available in any Rural Development office).

Evidence of ownership in accordance with 7 CFR part 3550.

Cost estimates or bid prices for removal of health or safety hazards in accordance with 7 CFR part 3550.

C. Section 514/516—Complete application packages will be submitted in accordance with the Notice of Funding Availability that will be published in the **Federal Register** each Fiscal Year.

D. Section 515—Complete application packages will be submitted in accordance with the Notice of Funding Availability that will be published in the **Federal Register** each Fiscal Year.

E. Section 524—Complete application packages will be submitted in accordance with § 1822.271(a) of subpart G of part 1822 of this chapter (paragraph XI.A. of RD Instruction 444.8). After Rural Development's review and as instructed, the application should be completed in accordance with § 1822.271(c) of subpart G of part 1822 of this chapter (paragraph XI.C. of RD Instruction 444.8).

F. Section 533—Complete application packages will be submitted in accordance with the requirements of subpart N of part 1944 of this chapter.

#### **Subpart D—Farm Labor Housing Loan and Grant Policies, Procedures, and Authorizations**

■ 27. Subpart D (§§ 1944.151 through 1944.200 and all exhibits) is removed and reserved.

#### **Subpart E—Rural Rental and Rural Cooperative Housing Loan Policies, Procedures, and Authorizations**

■ 28. Subpart E (§§ 1944.201 through 1944.250 and all exhibits) is removed and reserved.

#### **Subpart I—Self-Help Technical Assistance Grants**

##### **Exhibit F to Subpart I of Part 1944 [Amended]**

■ 29. Exhibit F to subpart I of part 1944 is amended in paragraph VII by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-51" to read "Form RD 3560-51."

#### **Subpart L—Farmers Home Administration or Its Successor Agency Under Public Law 103-354 Tenant Grievance and Appeals Procedure**

30. Subpart L (§§ 1944.551 through 1944.600 and all exhibits) is removed and reserved.

#### **Subpart N—Housing Preservation Grants**

■ 31. Section 1944.656 is amended by revising the definition of "Overcrowding" to read as follows:

##### **§ 1944.656 Definitions.**

\* \* \* \* \*

*Overcrowding.* Guidance is provided at 7 CFR 3560.155(e). These guidelines should result in an ideal range of persons per housing unit.

\* \* \* \* \*

#### **PART 1951—SERVICING AND COLLECTIONS**

■ 32. The authority citation for part 1951 continues to read as follows:

**Authority:** 5 U.S.C. 301; 7 U.S.C. 1932 Note; 7 U.S.C. 1989; 31 U.S.C. 3716; 42 U.S.C. 1480.

#### **Subpart A—Account Servicing Policies**

##### **§ 1951.1 [Amended]**

■ 33. Section 1951.1 is amended by revising the words "subpart K of part 1951 of this chapter" to read "7 CFR part 3560, subpart I."

#### **Subpart D—Final Payment on Loans**

■ 34. Section 1951.151 is amended by revising the last sentence to read as follows:

##### **§ 1951.151 Purpose.**

\* \* \* This subpart does not apply to direct single family housing customers or to the Rural Rental Housing, Rural Cooperative Housing, or Farm Labor Housing programs of the RHS.

#### **Subpart E—Servicing the Community and Direct Business Programs Loans and Grants**

##### **§ 1951.220 [Amended]**

■ 35. Section 1951.220 is amended:

■ a. In the last sentence of paragraph (f) by revising the words "noted on Form FmHA or its successor agency under Public Law 103-354 1905-10 'Management System Card—Association'" to read "tracked in the Multi-Family Housing Information System (MFIS)."

■ b. In the last sentence of paragraph (g) by revising the words "on Form FmHA or its successor agency under Public Law 103-354 1905-10" to read "in MFIS."

##### **§ 1951.223 [Amended]**

■ 36. Section 1951.223 is amended in paragraph (b)(4) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1951-33" to read "Form RD 3560-15" and in

paragraph (c)(3) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1951-33" to read "Form RD 3560-15."

#### **Subpart F—Analyzing Credit Needs and Graduation of Borrowers**

■ 37. Section 1951.266 is revised to read as follows:

##### **§ 1951.266 Special requirements for MFH borrowers.**

All requirements of 7 CFR part 3560, subpart K must be met prior to graduation and acceptance of the full payment from an MFH borrower.

#### **Subpart K—Predetermined Amortization Schedule System (PASS) Account Servicing**

■ 38. Subpart K (§§ 1951.501 through 1951.550) is removed and reserved.

#### **Subpart N—Servicing Cases Where Unauthorized Loan or Other Financial Assistance Was Received—Multiple Family Housing**

■ 39. Subpart N (§§ 1951.651 through 1951.700) is removed and reserved.

#### **PART 1955—PROPERTY MANAGEMENT**

■ 40. The authority citation for part 1955 continues to read as follows:

**Authority:** 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

#### **Subpart A—Liquidation of Loans Secured by Real Estate and Acquisition of Real and Chattel Property**

■ 41. Section 1955.1 is amended by adding a sentence at the end to read as follows:

##### **§ 1955.1 Purpose.**

\* \* \* This subpart does not apply to the Rural Rental Housing, Rural Cooperative Housing, or Farm Labor Housing programs of RHS.

■ 42. Section 1955.10 is amended by revising paragraph (d)(9) and in paragraph (h)(6) by removing the fifth sentence and by revising the last two sentences to read as follows:

##### **§ 1955.10 Voluntary conveyance of real property by the borrower to the Government.**

\* \* \* \* \*

(d) \* \* \*

(9) For MFH loans, assignment of Housing Assistance Payments (HAP) Contracts will be obtained. Rental Assistance will be retained until the State Director is advised by OGC that

the Agency has title to the property. After a voluntary conveyance, the Agency may transfer Rental Assistance in accordance with 7 CFR part 3560, subpart F.

\* \* \* \* \*

(h) \* \* \*

(6) \* \* \* If the project is to be removed from the Rural Development program, a minimum of 180 days' notice to the tenants is required. Letters of Priority Entitlement must be made available to any tenants that will be displaced.

\* \* \* \* \*

■ 43. Section 1955.15 is amended in paragraph (d)(2)(v) by removing the fifth sentence and by revising the first and last sentences to read as follows:

§ 1955.15 Foreclosure by the Government of loans secured by real estate.

\* \* \* \* \*

(d) \* \* \*

(2) \* \* \*

(v) For MFH loans, the acceleration notice will advise the borrower of all applicable prepayment requirements, in accordance with 7 CFR part 3560, subpart N. \* \* \* Letters of Priority Entitlement must be made available.

\* \* \* \* \*

Subpart B—Management of Property

■ 44. Section 1955.51 is amended in the introductory text by adding a sentence after the third sentence to read as follows:

§ 1955.51 Purpose.

\* \* \* This subpart does not apply to the Rural Rental Housing, Rural Cooperative Housing, or Farm Labor Housing programs of RHS. \* \* \*

\* \* \* \* \*

■ 45. Section 1955.55 is amended in paragraph (b)(2)(i) by revising the words "Subpart C of Part 1930 of this chapter" to read "7 CFR part 3560" and in paragraph (a) by revising the first sentence to read as follows:

§ 1955.55 Taking abandoned real or chattel property into custody and related actions.

(a) \* \* \* (Multi-family housing type loans will be handled in accordance with 7 CFR part 3560, subpart J.) \* \* \*

\* \* \* \* \*

§ 1955.61 [Amended]

■ 46. Section 1955.61 is amended by revising the words "Subpart L of Part 1944 of this chapter" to read "7 CFR part 3560, subpart D."

■ 47. Section 1955.65 is amended in paragraph (c)(1) by removing the fourth sentence and by revising the sixth sentence to read as follows:

§ 1955.65 Management of inventory and/or custodial real property.

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \* For MFH projects, tenant occupancy and selection will be in accordance with the occupancy standards set forth in 7 CFR part 3560, subpart D. \* \* \*

\* \* \* \* \*

§ 1955.66 [Amended]

■ 48. Section 1955.66 is amended in paragraph (a)(2)(ii) by revising the words "subpart C of part 1930 of this chapter" to read "7 CFR part 3560."

Subpart C—Disposal of Inventory Property

§ 1955.101 [Amended]

■ 49. Section 1955.101 is amended by adding the words "or to the Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing programs" to the end of the last sentence.

§ 1955.114 [Amended]

■ 50. Section 1955.114 is amended:

■ a. In paragraph (b) by revising the words "subpart E of part 1965 of this chapter" to read "7 CFR part 3560, subpart N."

■ b. In paragraph (c)(3) by revising the words "the information outlined in Exhibit A-7 of subpart E of part 1944 of this chapter" to read "documentation as required by the Agency."

■ c. In paragraph (c)(4) by revising the words "subpart E of part 1944 of this chapter" to read "7 CFR part 3560."

■ d. In paragraph (c)(5) by revising the words "the definition of 'project' set forth in subpart E of part 1944 of this chapter" to read "the requirements of 7 CFR part 3560, subpart K."

§ 1955.115 [Amended]

■ 51. Section 1955.115 is amended in paragraph (b) by revising the words "subpart E of part 1965 of this chapter" to read "7 CFR part 3560, subpart N."

§ 1955.117 [Amended]

■ 52. Section 1955.117 is amended in paragraph (c) by revising the words "FmHA or its successor agency under Public Law 103-354 1944-51" to read "RD 3560-51."

§ 1955.118 [Amended]

■ 53. Section 1955.118 is amended in paragraph (b)(3) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1944-51" to read "Form RD 3560-51."

§ 1955.141 [Amended]

■ 54. Section 1955.141 is amended:

■ a. In paragraph (d) by revising the words "Exhibit C of Subpart C of Part 1930 of this chapter" to read "7 CFR part 3560, subpart E."

■ b. In paragraph (e) by revising the words "Exhibit E of subpart C of part 1930 of this chapter" to read "7 CFR part 3560, subpart F."

PART 1956—DEBT SETTLEMENT

■ 55. The authority citation for part 1956 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989; 31 U.S.C. 3711; 42 U.S.C. 1480.

Subpart B—Debt Settlement—Farm Loan Programs and Multi-Family Housing

■ 56. Section 1956.51 is amended by revising the last sentence to read as follows:

§ 1956.51 Purpose.

\* \* \* This subpart does not apply to RHS direct Single Family Housing (SFH) loans, RHS NP loans secured by SFH property, or to the Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing programs.

§ 1956.85 [Amended]

■ 57. Section 1956.85 is amended in paragraph (b)(1) by removing the words "on Form FmHA or its successor agency under Public Law 103-354 1944-9, "Multiple Family Housing Payment Transmittal,"."

Subpart C—Debt Settlement—Community and Business Programs

§ 1956.143 [Amended]

■ 58. Section 1956.143 is amended in paragraph (c)(3)(iv)(G)(I) by revising the words "Form FmHA or its successor agency under Public Law 103-354 1951-33" to read "Form RD 3560-15."

PART 1965—REAL PROPERTY

Subpart B—Security Servicing for Multiple Housing Loans

■ 59. Subpart B (§§ 1965.51 through 1965.100) is removed and reserved.

Subpart E—Prepayment and Displacement Prevention of Multi-Family Housing Loans

■ 60. Subpart E (§§ 1965.201 through 1965.250 and all exhibits) is removed and reserved.

Chapter XXXV—[Amended]

■ 61. Part 3560, consisting of subparts A through P, is added to read as follows:

**PART 3560—DIRECT MULTI-FAMILY HOUSING LOANS AND GRANTS****Subpart A—General Provisions and Definitions**

- Sec.  
 3560.1 Applicability and purpose.  
 3560.2 Civil rights.  
 3560.3 Environmental requirements.  
 3560.4 Compliance with other Federal requirements.  
 3560.5 State, local or tribal laws.  
 3560.6 Borrower responsibility and requirements.  
 3560.7 Delegation of responsibility.  
 3560.8 Administrator's exception authority.  
 3560.9 Reviews and appeals.  
 3560.10 Conflict of interest.  
 3560.11 Definitions.  
 3560.12–3560.49 [Reserved]  
 3560.50 OMB control number.

**Subpart B—Direct Loan and Grant Origination**

- 3560.51 General.  
 3560.52 Program objectives.  
 3560.53 Eligible use of funds.  
 3560.54 Restrictions on the use of funds.  
 3560.55 Applicant eligibility requirements.  
 3560.56 Processing section 515 housing proposals.  
 3560.57 Designated places for section 515 housing.  
 3560.58 Site requirements.  
 3560.59 Environmental requirements.  
 3560.60 Design requirements.  
 3560.61 Loan security.  
 3560.62 Technical, legal, insurance, and other services.  
 3560.63 Loan limits.  
 3560.64 Initial operating capital contribution.  
 3560.65 Reserve account.  
 3560.66 Participation with other funding or financing sources.  
 3560.67 Rates and terms for section 515 loans.  
 3560.68 Permitted return on investment (ROI).  
 3560.69 Supplemental requirements for congregate housing and group homes.  
 3560.70 Supplemental requirements for manufactured housing.  
 3560.71 Construction financing.  
 3560.72 Loan closing.  
 3560.73 Subsequent loans.  
 3560.74 Loan for final payments.  
 3560.75–3560.99 [Reserved]  
 3560.100 OMB control number.

**Subpart C—Borrower Management and Operations Responsibilities**

- 3560.101 General.  
 3560.102 Housing project management.  
 3560.103 Maintaining housing projects.  
 3560.104 Fair housing.  
 3560.105 Insurance and taxes.  
 3560.106–3560.149 [Reserved]  
 3560.150 OMB control number.

**Subpart D—Multi-Family Housing Occupancy**

- 3560.151 General.  
 3560.152 Tenant eligibility.  
 3560.153 Calculation of household income and assets.

- 3560.154 Tenant selection.  
 3560.155 Assignment of rental units and occupancy policies.  
 3560.156 Lease requirements.  
 3560.157 Occupancy rules.  
 3560.158 Changes in tenant eligibility.  
 3560.159 Termination of occupancy.  
 3560.160 Tenant grievances.  
 3560.161–3560.199 [Reserved]  
 3560.200 OMB control number.

**Subpart E—Rents**

- 3560.201 General.  
 3560.202 Establishing rents and utility allowances.  
 3560.203 Tenant contributions.  
 3560.204 Security deposits and membership fees.  
 3560.205 Rent and utility allowance changes.  
 3560.206 Conversion to Plan II (Interest Credit).  
 3560.207 Annual adjustment factors for Section 8 units.  
 3560.208 Rents during eviction or failure to recertify.  
 3560.209 Rent collection.  
 3560.210 Special note rents (SNRs).  
 3560.211–3560.249 [Reserved]  
 3560.250 OMB control number.

**Subpart F—Rental Subsidies**

- 3560.251 General.  
 3560.252 Authorized rental subsidies.  
 3560.253 [Reserved]  
 3560.254 Eligibility for rental assistance.  
 3560.255 Requesting rental assistance.  
 3560.256 Rental assistance payments.  
 3560.257 Assigning rental assistance.  
 3560.258 Terms of agreement.  
 3560.259 Transferring rental assistance.  
 3560.260 Rental subsidies from non-Agency sources.  
 3560.261 Improperly advanced rental assistance.  
 3560.262–3560.299 [Reserved]  
 3560.300 OMB control number.

**Subpart G—Financial Management**

- 3560.301 General.  
 3560.302 Accounting, bookkeeping, budgeting, and financial management systems.  
 3560.303 Housing project budgets.  
 3560.304 Initial operating capital.  
 3560.305 Return on investment.  
 3560.306 Reserve account.  
 3560.307 Reports.  
 3560.308 Annual financial reports.  
 3560.309 Advancement (loan) of funds to a RRH project by the owner, member of the organization, or agent of the owner.  
 3560.310–3560.349 [Reserved]  
 3560.350 OMB control number.

**Subpart H—Agency Monitoring**

- 3560.351 General.  
 3560.352 Agency monitoring scope, purpose, and borrower responsibilities.  
 3560.353 Scheduling of on-site monitoring reviews.  
 3560.354 Borrower response to monitoring review notifications.  
 3560.355–3560.399 [Reserved]  
 3560.400 OMB control number.

**Subpart I—Servicing**

- 3560.401 General.  
 3560.402 Loan payment processing.  
 3560.403 Account servicing.  
 3560.404 Final loan payments.  
 3560.405 Borrower organizational structure or ownership interest changes.  
 3560.406 MFH ownership transfers or sales.  
 3560.407 Sales or other disposition of security property.  
 3560.408 Lease of security property.  
 3560.409 Subordinations or junior liens against security property.  
 3560.410 Consolidations.  
 3560.411–3560.449 [Reserved]  
 3560.450 OMB control number.

**Subpart J—Special Servicing, Enforcement, Liquidation, and Other Actions**

- 3560.451 General.  
 3560.452 Monetary and non-monetary defaults.  
 3560.453 Workout agreements.  
 3560.454 Special servicing actions related to housing operations.  
 3560.455 Special servicing actions related to loan accounts.  
 3560.456 Liquidation.  
 3560.457 Negotiated debt settlement.  
 3560.458 Special property circumstances.  
 3560.459 Special borrower circumstances.  
 3560.460 Double damages.  
 3560.461 Enforcement provisions.  
 3560.462 Money laundering.  
 3560.463 Obstruction of Federal audits.  
 3560.464–3560.499 [Reserved]  
 3560.500 OMB control number.

**Subpart K—Management and Disposition of Real Estate Owned (REO) Properties**

- 3560.501 General.  
 3560.502 Tenant notifications and assistance.  
 3560.503 Disposition of REO property.  
 3560.504 Sales price and bidding process.  
 3560.505 Agency loans to finance purchases of REO properties.  
 3560.506 Conversion of single family type REO property to MFH use.  
 3560.507–3560.549 [Reserved]  
 3560.550 OMB control number.

**Subpart L—Off-Farm Labor Housing**

- 3560.551 General.  
 3560.552 Program objectives.  
 3560.553 Loan and grant purposes.  
 3560.554 Use of funds restrictions.  
 3560.555 Eligibility requirements for off-farm labor housing loans and grants.  
 3560.556 Application requirements and processing.  
 3560.557 [Reserved]  
 3560.558 Site requirements.  
 3560.559 Design and construction requirements.  
 3560.560 Security.  
 3560.561 Technical, legal, insurance and other services.  
 3560.562 Loan and grant limits.  
 3560.563 Initial operating capital.  
 3560.564 Reserve accounts.  
 3560.565 Participation with other funding or financing sources.  
 3560.566 Loan and grant rates and terms.  
 3560.567 Establishing the profit base on initial investment.

- 3560.568 Supplemental requirements for seasonal off-farm labor housing.
- 3560.569 Supplemental requirements for manufactured housing.
- 3560.570 Construction financing.
- 3560.571 Loan and grant closing.
- 3560.572 Subsequent loans.
- 3560.573 Rental assistance.
- 3560.574 Operating assistance.
- 3560.575 Rental structure and changes.
- 3560.576 Occupancy restrictions.
- 3560.577 Tenant priorities for labor housing.
- 3560.578 Financial management of labor housing.
- 3560.579 Servicing off-farm labor housing.
- 3560.580–3560.599 [Reserved]
- 3560.600 OMB control number.

#### Subpart M—On-Farm Labor Housing

- 3560.601 General.
- 3560.602 Program objectives.
- 3560.603 Loan purposes.
- 3560.604 Restrictions on use of funds.
- 3560.605 Eligibility requirements.
- 3560.606 Application requirements and processing.
- 3560.607 [Reserved]
- 3560.608 Site and construction requirements.
- 3560.609 [Reserved]
- 3560.610 Security.
- 3560.611 Technical, legal, insurance and other services.
- 3560.612 Loan limits.
- 3560.613 [Reserved]
- 3560.614 Reserve accounts.
- 3560.615 Participation with other funding sources.
- 3560.616 Rates and terms.
- 3560.617 [Reserved]
- 3560.618 Supplemental requirements for on-farm labor housing.
- 3560.619 Supplemental requirements for manufactured housing.
- 3560.620 Construction financing.
- 3560.621 Loan closing.
- 3560.622 Subsequent loans.
- 3560.623 Housing management and operations.
- 3560.624 Occupancy restrictions.
- 3560.625 Maintaining the physical asset.
- 3560.626 Affirmative Fair Housing Marketing Plan.
- 3560.627 Response to resident complaints.
- 3560.628 Establishing and modifying rental charges.
- 3560.629 Security deposits.
- 3560.630 Financial management.
- 3560.631 Agency monitoring.
- 3560.632–3560.649 [Reserved]
- 3560.650 OMB control number.

#### Subpart N—Housing Preservation

- 3560.651 General.
- 3560.652 Prepayment and restrictive-use categories.
- 3560.653 Prepayment requests.
- 3560.654 Tenant notification requirements.
- 3560.655 Agency requested extension.
- 3560.656 Incentives offers.
- 3560.657 Processing and closing incentive offers.
- 3560.658 Borrower rejection of the incentive offer.
- 3560.659 Sale or transfer to nonprofit organizations and public bodies.

- 3560.660 Acceptance of prepayments.
- 3560.661 Sale or transfers.
- 3560.662 Restrictive-use provisions and agreements.
- 3560.663 Post-payment responsibilities for loans subject to continued restrictive-use provisions.
- 3560.664–3560.699 [Reserved]
- 3560.700 OMB control number.

#### Subpart O—Unauthorized Assistance

- 3560.701 General.
- 3560.702 Unauthorized assistance sources and situations.
- 3560.703 Identification of unauthorized assistance.
- 3560.704 Unauthorized assistance determination notice.
- 3560.705 Recapture of unauthorized assistance.
- 3560.706 Offsets.
- 3560.707 Program participation and corrective actions.
- 3560.708 Unauthorized assistance received by tenants.
- 3560.709 Demand letter.
- 3560.710–3560.749 [Reserved]
- 3560.750 OMB control number.

#### Subpart P—Appraisals

- 3560.751 General.
- 3560.752 Appraisal use, request, review, and release.
- 3560.753 Agency appraisal standards and requirements.
- 3560.754–3560.799 [Reserved]
- 3560.800 OMB control number.

Authority: 42 U.S.C. 1480.

#### Subpart A—General Provisions and Definitions

##### § 3560.1 Applicability and purpose.

(a) This part sets forth requirements, policies, and procedures for multi-family housing (MFH) direct loan and grant programs to serve eligible very-low, low- and moderate income households. The programs covered by this part are authorized by title V of the Housing Act of 1949 and are:

(1) *Section 515 Rural Rental Housing, which includes congregational housing, group homes, and Rural Cooperative Housing.* Section 515 loans may be made to finance multi-family units in rural areas as defined in § 3560.11.

(2) *Sections 514 and 516 Farm Labor Housing loans and grants.* Housing under these programs may be built in any area with a need and demand for housing for farm workers.

(3) *Section 521 Rental Assistance.* A project-based tenant rent subsidy which may be provided to Rural Rental Housing and Farm Labor Housing facilities.

(b) The programs covered by this part provide economically designed and constructed rural rental, cooperative, and farm labor housing and related facilities operated and managed in an

affordable, decent, safe, and sanitary manner.

(c) Internal Agency procedures containing details for Agency processing under these regulations can be found in the program handbooks, available in any Rural Development office, or from the Rural Development Web site.

##### § 3560.2 Civil rights.

(a) As per the Fair Housing Act, as amended and section 504 of the Rehabilitation Act of 1973, all actions taken by recipients of loans and grants will be conducted without regard to race, color, religion, sex, familial status, national origin, age, or disability. These actions include any actions in the sale, rental, or advertising of the dwellings, in the provision of brokerage services, or in residential real estate transactions involving Rural Housing Service (RHS) assistance. It is unlawful for a borrower or grantee or an agent of a borrower or grantee:

(1) To refuse to make reasonable accommodations in rules, policies, practices, or services that would provide a person with a disability an opportunity to use or continue to use a dwelling unit and all public and common use areas; or

(2) To refuse to provide a reasonable accommodation at the borrower's expense that would not cause an undue financial or administrative burden, or to refuse to allow an individual with a disability to make reasonable modifications to the unit at their own expense with the understanding that the owner may require the tenant to return the unit to its original condition when the unit is vacated by the tenant making the modifications (see § 3560.104(c)).

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

(c) Any tenant/member or prospective tenant seeking occupancy in or use of facilities financed by the Agency who

believes he or she is being discriminated against because of race, color, religion, sex, familial status, national origin, or disability may file a complaint in person with, or by mail to the U. S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, Washington, DC 20410. Complaints received by Agency employees must be directed to the National Office Civil Rights staff through the State Civil Rights Manager/Coordinator.

(d) Borrowers or grantees that fail to comply with the requirements of federal civil rights requirements are subject to sanctions authorized by law. The following are the major civil rights laws affecting multifamily housing loan and grant programs:

- (1) Equal Credit Opportunity Act (ECOA).
- (2) Title VI of the Civil Rights Act of 1964.
- (3) Title VIII of the Civil Rights Act of 1968.
- (4) Section 504 of the Rehabilitation Act of 1973.
- (5) Age Discrimination Act of 1975.
- (6) Title IX of the Education Amendments of 1972.

#### **§ 3560.3 Environmental requirements.**

RHS will consider environmental impacts of proposed housing as equal with economic, social, and other factors. By working with applicants, Federal agencies, Indian tribes, state and local governments, interested citizens, and organizations, RHS will formulate actions that advance program goals in a manner that protects, enhances, and restores environmental quality. Loan and grant processing and servicing actions taken by RHS under this part are subject to an environmental review conducted in accordance with 7 CFR part 1940, subpart G or any successor regulation.

#### **§ 3560.4 Compliance with other Federal requirements.**

RHS is responsible for ensuring that the application is in compliance with all applicable Federal requirements, including the following specific requirements:

(a) *Intergovernmental review.* 7 CFR part 3015, subpart V, or any successor regulation, including the Agency supplemental administrative instruction, RD Instruction 1940-J, available in any Rural Development office.

(b) *National flood insurance.* The National Flood Insurance Act of 1968, as amended by the Flood Disaster Protection Act of 1973; the National Flood Insurance Reform Act of 1994;

and 7 CFR part 1806, subpart B, or any successor regulation.

(c) *Clean Air Act and Water Pollution Control Act Requirements.* For any contract, all applicable standards, orders or requirements issued under section 306 of the Clean Air Act; section 508 of the Clean Water Act, Executive Order 11738, and 40 CFR part 32.

(d) *Historic preservation requirements.* The provisions of 7 CFR part 1901, subpart F or any successor regulation.

(e) *Lead-based paint requirements.* The applicable provisions of 24 CFR part 35, subparts A through D, J, and R, as published by the U.S. Department of Housing and Urban Development.

#### **§ 3560.5 State, local or tribal laws.**

Borrowers must comply with all applicable state and local laws, and laws of Federally-recognized Indian tribes to the extent they are not inconsistent with this part.

#### **§ 3560.6 Borrower responsibility and requirements.**

(a) Borrower responsibilities and requirements specified in this part may be carried out by an individual or entity designated by the borrower to act on behalf of the borrower such as a resident manager or management agent. Ultimate accountability to the Agency, however, is with the borrower whether or not the borrower designated another person or entity to act on the borrower's behalf.

(b) Borrowers who have not executed a loan agreement, and who were not required to execute a loan agreement by the regulations in effect at the time of their loan closing are exempt from the requirements of subparts D through G of this part, as long as the borrower is not in default of any applicable requirement, security instrument, payment, or any other agreement with the Agency. Such borrowers must provide evidence of tenant income eligibility in accordance with § 3560.152(a), except in Farm Labor Housing where the tenant is not paying shelter cost.

#### **§ 3560.7 Delegation of responsibility.**

The RHS Administrator may delegate, on an individual or other basis, any decision-making responsibility for Agency programs, unless otherwise noted.

#### **§ 3560.8 Administrator's exception authority.**

The RHS Administrator may make an exception to any provision of this part or address any omissions provided that the exception is consistent with the applicable statute, does not adversely affect the interest of the Federal

Government, and does not adversely affect the accomplishment of the purposes of the MFH programs or application of the requirement would result in undue hardship on the tenants. Exception requests presented to the RHS Administrator must have the concurrence of a Rural Development State Director or a Deputy Administrator for MFH.

#### **§ 3560.9 Reviews and appeals.**

Rural Housing Service decisions may be appealed pursuant to 7 CFR part 11.

#### **§ 3560.10 Conflict of interest.**

To reduce the potential for employee conflict of interest, all RHS activities will be conducted in accordance with 7 CFR part 1900, subpart D.

#### **§ 3560.11 Definitions.**

Unless otherwise noted, terms listed in this part shall be defined as follows: *Administrator.* The head of the Rural Housing Service who reports directly to the Under Secretary for Rural Development in the U.S. Department of Agriculture.

*Agency.* The Rural Housing Service within the Rural Development mission area of the U.S. Department of Agriculture.

*Amortization.* Payment of debt in regular, periodic installments of principal and interest, as opposed to interest only payments.

*Applicant.* An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe, association, or other entity that will be the owner of the project for which an application for funding from the Agency is submitted.

*Appraisal.* As used by the Agency, a written report developed by a qualified appraiser as established in subpart P that concludes an opinion of value(s) for a specific real property.

*Assistance.* Financial assistance in the form of a loan, grant, interest credit, or rental assistance.

*Association of farmers.* Two or more farmers acting as a single legal entity. Association members may include the individual members of farming partnerships or corporations.

*Borrower.* An individual, partnership or limited partnership, consumer cooperative, trust, state or local public agency, corporation, limited liability company, nonprofit organization, Indian tribe, association, or other entity that has received a loan from the Agency.

*Capital Needs Assessment.* A Capital Needs Assessment is designed to capture and report on the immediate

and the long-range capital needs of an individual property. It includes attention to site features, mechanical and electrical systems, building exterior and common area systems, and dwelling unit interiors.

**Caretaker.** An individual employed by a borrower or a management agent to handle routine interior and exterior maintenance and upkeep of a MFHMFH project.

**Congregate housing.** A housing program authorized by section 515 of the Housing Act of 1949 which provides housing for elderly persons, individuals with disabilities, and families who require some supervision and central services but are otherwise able to care for themselves. Such housing does not include any licensed healthcare facility.

**Consumer cooperative.** A corporation organized under the cooperative laws of a state or Federally recognized Indian tribe that will own and operate the housing on a cooperative basis solely for the benefit of its members.

**Conventional rents for comparable units (CRCU).** Market rents for comparable rental units in conventional housing located in the same geographic area as a particular Section 514, 515, or 516 project.

**Current appraisal.** An appraisal with a report date that is no more than 1 year old.

**Daily Interest Accrual System (DIAS).** A system where interest is charged daily on outstanding principal. Level loan payments are made by the borrower. The amount of interest due on any date is equal to the unpaid daily interest that has accrued.

**Default.** Failure by a borrower to meet significant monetary or non-monetary obligations or terms of a loan, grant, or other agreement with the Agency which remain unpaid or unperformed for more than 30 days after the date such obligation is due or required to be paid or performed, or within time periods specified in notices of compliance violations.

**Disability.** The term disability is considered equivalent to the term handicap. Eligibility requirements for fully accessible units are contained in §§ 3560.154(g)(1)(i) and 3560.155(b). A person is considered to have a disability if either of the following two situations occur:

(1) *As defined in section 501(b) of the Housing Act of 1949.* The person is the head of household (or his or her spouse) and is determined to have an impairment which:

(i) Is expected to be of long-continued and indefinite duration;

(ii) Substantially impedes his or her ability to live independently; and

(iii) Is of such a nature that such ability could be improved by more suitable housing conditions, or if such person has a developmental disability as defined in section 102(7) of the Developmental Disability and Bill of Rights Act (42 U.S.C. 6001(7)).

(2) *As defined in the Fair Housing Act; the Americans with Disabilities Act; and section 504 of the Rehabilitation Act of 1973.* The person has a physical or mental impairment which substantially limits one or more of such person's major life activities; a record of such impairment; or being regarded as having such an impairment. The term does not include current, illegal use of or addiction to a controlled substance. As used in this definition, physical or mental impairment includes:

(i) Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological; musculoskeletal; special sense organs; respiratory, including speech organs; cardiovascular; reproductive; digestive; genito-urinary; hemic and lymphatic; skin; and endocrine;

(ii) Any mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities. The term "physical or mental impairment" includes, but is not limited to, such diseases and conditions as orthopedic, visual, speech and hearing impairments, cerebral palsy, autism, epilepsy, muscular dystrophy, multiple sclerosis, cancer, heart disease, diabetes, Human Immunodeficiency Virus infection, mental retardation, emotional illness, drug addiction (other than addiction caused by current, illegal use of a controlled substance), and alcoholism;

(iii) Major life activities means functions such as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working;

(iv) Has a record of such an impairment means has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities;

(v) Is regarded as having an impairment means:

(A) Has a physical or mental impairment that does not substantially limit one or more major life activities but that is treated by the borrower or management agent as constituting such a limitation;

(B) Has a physical or mental impairment that substantially limits one or more major life activities only as a

result of the attitudes of others toward such impairment; or

(C) Has none of the impairments described in this definition but is treated by another person as having such an impairment.

**Disabled domestic farm laborer.** An individual with a disability as separately defined in this paragraph and who was a domestic farm laborer at the time of becoming disabled.

**Domestic farm laborer.** A person who, consistent with the requirements in § 3560.576(b)(2), receives a substantial portion of his or her income from farm labor employment (not self-employed) in the United States, Puerto Rico, or the Virgin Islands and either is a citizen of the United States or resides in the United States, Puerto Rico or the Virgin Islands after being legally admitted for permanent residence. This definition may include the immediate family members residing with such a person.

**Due diligence on hazardous substances.** Due diligence is the process of inquiring into the environmental conditions of real estate, in the context of a real estate transaction to determine the presence of contamination from hazardous substances, and to determine the impact such contamination may have on the market value of the property.

**Elderly household or individual with a handicapped household.** A household in which the tenant or co-tenant of the household is 62 years old or older or is an individual with a disability. An elderly household may include persons younger than 62 years old and the household of an individual with a handicap may include persons without disabilities.

**Elderly person.** A person who is at least 62 years old. The term also means a person with a disability as separately defined in this paragraph, regardless of age.

**Engagement.** An Agency defined financial review of a housing project's financial status that a borrower will contract with a certified public accountant or other qualified individual to perform. An engagement will result in annual financial reports for use by the Agency as described in § 3560.308.

**Familial status.** One or more individuals (who have not attained the age of 18 years) being domiciled with a parent or another person having legal custody of such individual or individuals; or the designee of such parent or other person having such custody, with the written permission of such parent or other person. The protections afforded against discrimination on the basis of familial status shall apply to any person who is

pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years.

**Family farm corporation or partnership.** A private corporation or partnership involved in agricultural production in which at least 90 percent of the stock or interest is owned and controlled by persons related by blood, which shall include parents, siblings, and children, or law. If more than three separate households are supported by the farming operation, the family farm corporation or partnership must be:

(1) Legally organized and authorized to own and operate a farm business within the state;

(2) Legally able to carry out the purposes of the loan; and

(3) Prohibited from the sale or transfer of 90 percent of the stock or interest to other than family members by either the articles of incorporation, bylaws or by agreement between the stockholders or partners and the corporation or partnership.

**Farm.** A tract or tracts of land, improvements, and other appurtenances that are used or will be used in the production of crops, livestock, or aquaculture products for sale in sufficient quantities so that the property is recognized as a farm rather than a rural residence. The term "farm" also includes the term "ranch." It may also include land and improvements and facilities used in a non-eligible enterprise or the residence that, although physically separate from the farm acreage, is ordinarily treated as part of the farm in the local community.

**Farmer.** A person who is actually involved in day to day on-site operations of a farm and who devotes a substantial amount of time to personal participation in the conduct of the operation of a "farm."

**Farm labor.** Services in connection with cultivating the soil, raising or harvesting any agriculture or aquaculture commodity; or in catching, netting, handling, planting, drying, packing, grading, storing, or preserving in the unprocessed stage, without respect to the source of employment (but not self-employed), any agriculture or aquaculture commodity; or delivering to storage, market, or a carrier for transportation to market or to processing any agricultural or aquacultural commodity in its unprocessed stage.

**Farm labor contractor.** A person—other than an agricultural employer, a member of an agricultural association, or an employee of an agricultural employer or agricultural association—who recruits, solicits, hires, employs, furnishes, or transports any year-round

or seasonal migrant farm laborer for money or other valuable consideration.

**Farm labor housing.** On-farm or off-farm housing for farm laborers authorized by section 514 and section 516 of the Housing Act of 1949.

**Farm owner.** A natural person, persons, or legal entity who are the owners of a "farm" as this term is further defined in this section.

**Foreclosure.** A proceeding in or out of court to extinguish all rights, title, and interest of the owners of property in order to sell the property to satisfy a lien against it.

**General overhead.** Includes general operation items necessary for the contractor to be in business. They may include, but are not limited to the following: tools and minor equipment; worker's compensation and employer's liability; unemployment tax; Social Security and Medicare; manager's, clerical, and estimator's salaries; pension and bonus plans; main office insurance, rental, utilities, miscellaneous expenses; general liability insurance; legal, accounting, and data processing; automotive and light truck expense; vehicle expenses; depreciation of overhead capital expenditures; and office equipment maintenance.

**General requirements.** Includes items that are required in the construction contract for the contractor to provide for the specific project. They do not include items that pertain to a specific trade nor overhead expenses of the contractor's general operation. Items may include, but are not limited to, the following: Field supervision; field engineering such as field office, sheds, toilets, phone; performance and payment or latent defects bonds; cost certification; building permits; site security; temporary utilities; property insurance; and cleaning or rubbish removal.

**Grantee.** An entity that has received a grant from the Agency.

**Group home.** Housing that is occupied by elderly persons or individuals with disabilities who share living space within a rental unit and in which a resident assistant may be required.

**Household.** The tenant or co-tenant and the persons or dependents living with a tenant or co-tenant, but not including a resident assistant.

**Household furnishings.** Basic durable items such as stoves, refrigerators, drapes, drapery rods, tables, chairs, dressers and beds.

**Housing project.** A property with two or more affordable, decent, safe and sanitary rental units and related facilities operated under one management plan and financed with

funds appropriated under the authority of sections 515, 514, or 516 of the Housing Act of 1949.

**Identity-of-Interest (IOI).** A relationship between applicants, borrowers, grantees, management agents, or suppliers of materials or services described under, but not limited to, any of the following conditions:

(1) There is a financial interest between the applicant, borrower, grantee and a management agent or the supplying entity;

(2) One or more of the officers, directors, stockholders or partners of the applicant, borrower, or management agent is also an officer, director, stockholder, or partner of the supplying entity;

(3) An officer, director, stockholder, or partner of the applicant, borrower, or management agent has a 10 percent or more financial interest in the supplying entity;

(4) The supplying entity has or will advance funds to an applicant, borrower, or management agent;

(5) The supplying entity provides or pays on behalf of the applicant, borrower, or management agent the cost of any materials or services in connection with obligations under the management plan or management agreement;

(6) The supplying entity takes stock or a financial interest in the applicant, borrower, or management agent as part of the consideration to be paid them; or

(7) There exists or come into being any side deals, agreements, contracts or understandings entered into thereby altering, amending, or canceling any of the management plan, management agreement documents, organization documents, or other legal documents pertaining to the property, except as approved by the Agency.

**Indian tribe.** The term "Indian tribe" means any Indian tribe, band, group, and nation, including Alaskan Indians, Aleuts, and Eskimos, and any Alaskan-Native Village, which is considered an eligible recipient under the Indian Self-Determination and Education Assistance Act (Public Law 93-638) or under the State and Local Fiscal Assistance Act of 1972 (Public Law 92-512).

**Interest credit.** A form of assistance available to eligible borrowers that reduces the effective interest rate of the loan.

**Lease.** A contract setting forth the rights and obligations of a tenant or cooperative member and a property owner, including charges and terms under which a tenant or cooperative

member will occupy or use the housing or related facilities.

*Legal or qualified alien.* Legal or qualified alien refers to any person lawfully admitted to the country who meets the criteria in section 214 of the Housing and Community Development Act of 1980, 42 U.S.C. 1436a.

*Letter of Priority Entitlement (LOPE).* A letter issued by the Agency providing a tenant with priority entitlement to rental units in other Agency-financed housing projects for 120 days from the date of the LOPE.

*Life cycle cost.* The life cycle cost has 2 purposes: (1) To determine the expected usable life (utility) of a building component or furnishing and (2) to determine which building components or furnishings are the most cost efficient over the life of the building. Cost efficient is not to be construed to mean the least initial cost.

*Life cycle cost analysis.* Life cycle cost analysis is the comparison of different materials to examine anticipated useful life and the cost of using a specific material or building component. The analysis has multiple uses, such as: (1) To conduct a cost efficiency comparison between products, (2) for developing component replacement time tables, and (3) for estimating future component replacement costs. Life cycle cost analysis can be accomplished through various methods, such as; insurance actuary tables or Agency documentation of a component's life expectancy. Life cycle cost analysis is conducted by a design professional. For Agency financed projects, a life cycle cost analysis is to be conducted for specific components: (1) drives and parking, (2) roofing system and roofing material, (3) exterior finishes, and (4) energy source items.

*Limited Liability Company (LLC).* An unincorporated organization of one or more persons or entities established in accordance with applicable state laws and whose members may actively participate in the organization without being personally liable for the debts, obligations or liabilities of the organization.

*Limited partnership.* An ownership arrangement consisting of general and limited partners; general partners manage the business, while limited partners are passive and liable only for their own capital contributions.

*Loan agreement.* A written agreement between the Agency and the borrower that sets forth the borrower's responsibilities with respect to Agency financing.

*Low-income household.* A household that has an adjusted income that is greater than the Department of Housing

and Urban Development's (HUD) established very-low income limit, but that does not exceed the HUD established low-income limit (generally 80 percent of median income adjusted for household size for the county where the property is or will be located).

*Low-Income Housing Tax Credit (LIHTC).* A federal tax credit allowed for investment in qualified low-income housing administered by the Internal Revenue Service (IRS) under section 42 of the Internal Revenue Code.

*Management agent.* A firm or individual employed or designated by a borrower to act on the borrower's behalf in accordance with a written management agreement.

*Management agreement.* A written agreement between a borrower and a management agent setting forth the management agent's responsibilities and fees for management services.

*Management fee.* The compensation provided to a management agent for services provided in accordance with a management agreement.

*Management plan.* A detailed description of the policies and procedures to be followed by the borrower in managing a MFH project.

*Manufactured housing.* Housing, constructed of one or more factory-built sections, which includes the plumbing, heating, and electrical systems contained therein, which is built to comply with the Federal Manufactured Home Construction and Safety Standards (FMHCSS), and which is designed to be used with a permanent foundation.

*Market area.* The geographic or locational delineation of the market for a specific project, including outlying areas that will be impacted by the project, *i.e.*, the area in which alternative, similar properties effectively compete with the subject property.

*Market rent.* The most probable rent that a property should bring in a competitive and open market reflecting all conditions and restrictions of the specified lease agreement, including term, rental adjustment and revaluation, permitted uses, use restrictions, and expense obligations; the lessee and lessor each acting prudently and knowledgeably, and assuming consummation of a lease contract as a specified date and the passing of the leasehold from lessor to lessee.

*Maximum debt limit.* The maximum amount that the Agency will lend or grant for a MFHMFH project based on the appraised value or total development cost excluding costs ineligible for payment from loan or grant funds, whichever is less, reduced by all funding available to the borrower

from sources other than the Agency, multiplied by 95, 97, or 102 percent depending upon the applicant entity and their use of the low-income housing tax credit, in accordance with § 3560.63(b).

*Member or co-member.* A stockholder or other person who has executed documents or stock pertaining to a cooperative housing type of living arrangement and has made a commitment to upholding the cooperative concept.

*Migrants or migrant agricultural laborer.* A person (and the family of such person) who receives a substantial portion of his or her income from farm labor employment and who establishes a residence in a location on a seasonal or temporary basis, in an attempt to receive farm labor employment at one or more locations away from their home base state, excluding day-haul agricultural workers whose travels are limited to work areas within one day of their residence.

*Minor.* An individual under 18 years of age who is a dependent of a tenant or an individual age 18 or older who is a full-time student and a dependent of a tenant.

*Moderate-income household.* A household that has an adjusted income that is greater than the HUD-established low-income limit but does not exceed the low-income limit by more than \$5,500.

*Mortgage or Deed of Trust.* A form or security instrument or consensual lien on real property.

*Net recovery value.* The value realized from the Government's acquisition of security property in a default situation after subtracting all costs, actual or anticipated, from acquiring, holding, and disposing of the security property.

*New construction.* A MFHMFH project being constructed to be occupied for the first time.

*Nonprofit organization.* A private organization that:

- (1) Is organized under state or local laws;
- (2) Has no part of its net earnings inuring to the benefit of any member, founder, contributor, or individual; and
- (3) Is approved by the Secretary of Agriculture and considered to be financially responsible.

*Nonprofit organization for section 515 program (Prepayment or Purchase).* To be eligible to purchase properties under the conditions of subpart N of this part, nonprofit organizations may not have among their officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under section

515 that have been prepaid or have requested prepayment.

**Nonprofit organization of farm workers.** A nonprofit organization, as defined in this section, whose membership is composed of at least 51 percent farm workers.

**Notice of Funding Availability (NOFA).** A "Notice of Funding Availability" issued by the Agency to inform interested parties of the availability of assistance and other matters pertinent to the program.

**Occupancy agreement.** A contract establishing the rights and obligations of the cooperative member and the cooperative, including the amount of the monthly occupancy charge and the other terms under which the member will occupy the housing.

**Occupancy charge.** The amount of money charged a cooperative member to cover their proportional share of the cooperative's operating costs and cash requirements.

**Off-farm labor housing.** Housing for farm laborers in any location approved by the Agency but not on the farm where the laborer works.

**Office of the General Counsel (OGC).** The USDA Office of the General Counsel, including the Regional Attorney, Associate Regional Attorney, or Assistant Regional Attorney.

**Office of the Inspector General (OIG).** The USDA Office of the Inspector General.

**On-farm labor housing.** Housing for farm laborers located on the farm where they work that is away from service buildings or in the nearby community.

**Overage.** That portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal to the difference between the note rent for a unit and the basic rent.

**Plan I.** A type of interest subsidy available to borrowers prior to October 27, 1980. Budgets and rental rates developed for Plan I loans are based on a 3 percent loan amortization.

**Plan II.** A type of interest subsidy available to borrowers operating on a limited profit basis. Budgets and rental rates developed for Plan II loans are based on both the loan being amortized at the interest rate shown on the promissory note and at a 1 percent subsidized rate.

**Predetermined Amortization Schedule System (PASS).** A system where loan payments are applied based on an amortization schedule.

**Prepayment.** Payment in full of the outstanding balance on an Agency loan prior to the note's originally scheduled maturity date.

**Program requirements.** All provisions related to MFHMFH contained in the loan document, grant agreement, statute, regulation, handbook, or administrative notice.

**Promissory note.** A legal document containing conditions (interest rate and timing) for repayment of indebtedness.

**Real estate owned (REO) property.** The real estate owned by the Agency acquired through voluntary conveyance, foreclosure or other action.

**Rehabilitation.** Rehabilitation is when the remodeling of a property is of a complex nature involving structural repairs or when two or more of the life cycle cost components are included in the remodeling of a property.

**Related facilities.** Facilities in a MFHMFH project that are related to the housing and are in addition to rental units, (e.g., community rooms or buildings, cafeterias, dining halls, infirmaries, child care facilities, assembly halls, and essential service facilities such as central heating, sewerage, lighting systems, clothes washing facilities, trash disposal and safe domestic water supply).

**Rent.** The amount established as a charge for occupancy in a rental unit of Agency-financed MFH. Rents must be established at the same rate for all similar units in the housing project. The following terms are used to describe rents for various program purposes.

(1) **Note rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in the promissory note.

(2) **Basic rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in the promissory note reduced by the interest credit agreement.

(3) **HUD contract rent** is the rental charge established for housing receiving project-based Section 8 rental subsidies in accordance with 24 CFR part 880 or part 884, as applicable.

(4) **Low-income housing tax credit (LIHTC) rent** is the rental charge established in accordance with LIHTC requirements.

**Rental assistance (RA).** The portion of the approved shelter cost paid by the Agency to compensate a borrower for the difference between the approved shelter cost and the tenant contribution when such contribution is less than the basic rent.

**Rental assistance units.** Dwelling units in a MFH project qualified for rental assistance. There are three types of rental assistance units.

(1) New construction units are units provided in conjunction with initial loans for construction or substantial rehabilitation of the MFHMFH projects.

(2) Replacement units are Agency-funded rental assistance units which replace units with expiring rental assistance agreements or which replace Section 8 units which have expired under the Section 8 contract.

(3) Servicing units are units provided to an operational MFHMFH project as a part of the Agency's general loan servicing or preservation activities.

**Repair and replacement.** Repair and replacement is the restoration of minor building materials, elements, components, equipment and fixtures. Examples include: Painting, carpeting, appliances, cabinets, and other fixtures.

**Resident assistant.** A person residing in a rental unit who is essential to the well-being and care of an elderly person or an individual with a disability, but who:

(1) Is not obligated for the tenant's financial support;

(2) Would not be living in the unit except to provide the needed services;

(3) May be a family member, but is not a dependent of the tenant for tax purposes;

(4) Is not subject to the eligibility requirements of a tenant; and

(5) Is not considered a household member in the determination of household income.

**Resident or site manager.** The individual employed by the borrower and who is responsible for the day-to-day operations of the housing.

**Retired domestic farm laborer.** An individual who is at least 55 years of age and who has spent the last 5 years prior to retirement as a domestic farm laborer or spent the majority of the last 10 years prior to retirement as a domestic farm laborer.

**Return on Investment (ROI).** The annual amount of profit an owner operating on a limited or full profit basis may withdraw from a project, as established in the loan agreement. The amount is calculated as a percentage of the owner's investment in the project.

**Rural area.** Any open country, or any place, town, village, or city which is not (except in the cases of Pajaro, in the State of California, and Guadalupe, in the State of Arizona) part of or associated with an urban area and which (1) has a population not in excess of 2,500 inhabitants, or (2) has a population in excess of 2,500 but not in excess of 10,000 if it is rural in character, or (3) has a population in excess of 10,000 but not in excess of 20,000 and (A) is not contained within a standard metropolitan statistical area,

and (B) has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary and the Secretary of Housing and Urban Development. For purposes of this title, any area classified as "rural" or a "rural area" prior to October 1, 1990, and determined not to be "rural" or a "rural area" as a result of data received from or after the 1990 or 2000 decennial census shall continue to be so classified until the receipt of data from the decennial census in the year 2010, if such area has a population in excess of 10,000 but not in excess of 25,000, is rural in character, and has a serious lack of mortgage credit for lower and moderate-income families. Notwithstanding any other provision of this section, the city of Plainview, Texas, shall be considered a rural area for purposes of this title, and the city of Altus, Oklahoma, shall be considered a rural area for purposes of this title until the receipt of data from the decennial census in the year 2000.

**Rural Cooperative Housing (RCH).** A housing program authorized under section 515 of the Housing Act of 1949, in which a consumer cooperative, organized and operating on a nonprofit basis, may own and operate a MFHMFH development.

**Rural Housing Service (RHS).** The Agency within the Rural Development mission area of the U.S. Department of Agriculture or its successor agency which administers programs authorized by sections 514, 515, 516, and 521 of the Housing Act of 1949, as amended.

**Rural Rental Housing (RRH).** A housing program authorized by section 515 of the Housing Act of 1949 to provide rental housing in rural areas for persons of very-low, low- and moderate income.

**Seasonal housing.** Housing operated on a seasonal basis, typically for migrants or migrant agricultural laborers as opposed to year round.

**Security deposit.** A one-time fee charged a tenant prior to occupancy of a unit to cover possible loss or damage to the housing unit caused by the tenant.

**Self-employed.** A person who meets the IRS definition of self-employed at 26 CFR 1.401-10.

**Service agreement.** A written agreement between a borrower and a service provider establishing the specific service to be provided to a MFH project, the cost of the service, and the length of time the service will be provided.

**Service plan.** A written plan describing how services will be provided to a MFH project and which, at a minimum, must specify the services

to be provided, the frequency of the services, who will provide the services, how tenants will be advised of the availability of services, and the staff needed to provide the services.

**Service provider.** A person who signs a written agreement with a borrower to provide services to a MFH project.

**Shelter costs.** Basic or note rent plus the utility allowance, when used, or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

**Sources and Uses Comprehensive Evaluation (SAUCE).** A computer software program used by the Agency to analyze the total funds provided to a MFH project to ensure that the Agency is not providing excess assistance.

**Special note rent (SNR).** A rental rate charged at a Plan II project experiencing vacancies that is less than note rent but higher than basic rent.

**State consolidated plan.** A planning document for an individual state that includes a housing and homeless needs assessment; a housing market analysis; a strategic plan for addressing the state's housing challenges; an Action Plan that is an annual description of the state's Federal and other resources that are expected to be available to address its priority housing needs and how the Federal funds will leverage other resources; certifications relating to fair housing, its antidisplacement and relocation plan, a drug-free workplace, and other statutory and program requirements; and a monitoring plan to ensure that the state is using its Federal funds appropriately and effectively.

**Tenant or co-tenant.** An individual who signs a lease and occupies or will occupy a rental unit in a MFH project. The term tenant or co-tenant also refers to a member of cooperative housing occupying or planning to occupy a dwelling unit in cooperative housing.

**Tenant contribution.** The portion of the approved shelter cost paid by the tenant household. The proportion of tenant income and adjusted income paid will vary according to the type of subsidy provided to the tenant household.

**Total development cost (TDC).** The cost of constructing, purchasing, improving, altering, or repairing MFH and related facilities, buying household furnishings (for sections 514/516 only), and purchasing or improving the necessary land, including architectural, engineering, or legal fees, and charges and other technical and professional fees and charges, but excluding fees, charges, or commissions such as payments to brokers, negotiators, or other persons for the referral of

prospective applicants or solicitations of loans. Although a developer's fee is part of the project's development cost, such fees are not eligible for payment from Agency loan or grant funds and are not included in determining the Agency authorized development cost.

**Utility allowance.** An amount determined by a borrower as the amount to be considered a tenant's portion of utility cost in the calculation of a tenant's total shelter cost when utility costs are not included in the rent.

**Very low-income household.** A household that has an adjusted income that does not exceed the HUD established very low-income limit (generally 50 percent of median income adjusted for household size in the county where the property is or will be located).

**Workout agreement.** An agreement between a borrower and the Agency listing actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

#### §§ 3560.12–3560.49 [Reserved]

#### § 3560.50 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

#### Subpart B—Direct Loan and Grant Origination

##### § 3560.51 General.

This subpart contains the Agency's loan origination requirements for multi-family housing (MFH) direct loans for Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing. Additional requirements for farm labor housing loans and grants are contained in subpart L of this part for Off-Farm Labor Housing and subpart M of this part for On-Farm Labor Housing.

##### § 3560.52 Program objectives.

The Agency uses appropriated funds to finance the construction, rehabilitation of program properties, or purchase and rehabilitation of MFH and

related facilities to serve eligible persons in rural areas. The Agency encourages the use of such financing in conjunction with funding or financing from other sources.

**§ 3560.53 Eligible use of funds.**

Funds may be used for the following purposes.

(a) *Construct housing.* Funds may be used to construct MFH.

(b) *Purchase and rehabilitate buildings.* Funds may be used to purchase and rehabilitate buildings that have not been previously financed by the Agency.

(1) Rehabilitation must meet the definition of either moderate or substantial rehabilitation as defined in 7 CFR part 1924, subpart A.

(2) The building to be rehabilitated must be structurally sound and the improvements to the building must be necessary to meet the requirements of decent, safe, and sanitary living units.

(3) The total development cost (TDC) for the purchase and rehabilitation of existing buildings must not be more than the estimated TDC for construction of a similar type and unit size property in the same area.

(c) *Subsequent loans.* Funds may be used to provide subsequent loans in accordance with the provisions of § 3560.73.

(d) *Purchase and improve sites.* Funds may be used to purchase and improve the site on which MFH will be located, provided that the amount of loan funds used to purchase the site does not exceed the appraised market value of the site immediately prior to purchase.

(e) *Develop and install necessary systems.* Funds may be used to install streets, a water supply, sewage disposal, heating and cooling systems, electric, gas, solar, or other power sources for lighting and other features necessary for the housing. If such facilities are located off-site, loan funds may only be used if the following additional requirements are met:

(1) The loan applicant will hold title to the facility or have a legal right to use the facility in the form of an easement or other instrument acceptable to the Agency for a period of at least 50 percent longer than the term of the loan or grant and the title or right is transferable to any subsequent owner of the housing.

(2) The facilities will either be provided for the exclusive use of the proposed housing project, or Agency funds are limited to the prorated part of the total cost of the facility according to the use and benefit to the MFH project. If entities other than the housing project financed by the Agency use the facilities

on a reimbursable fee basis, the loan applicant must agree, in writing, to apply any fees collected in excess of operating expenses to their Agency loan account as an extra loan payment.

(f) *Landscaping and site development.* Funds may be used to provide landscaping and site development related to a MFH project such as lighting, walks, fences, parking areas, and driveways.

(g) *Tenant-related facilities.* Funds may be used to develop tenant-related facilities appropriate to the size, economics, and prospective tenants of a MFH project, such as a community room, development of space for education and training purposes for tenants, central laundry facility, outdoor seating, space for passive recreation, tot lots, and a small emergency care infirmary. In congregate housing and group homes, funds may be used for central cooking and dining areas.

(h) *Management-related facilities.* Funds may be used to develop management-related facilities appropriate to the size and economics of a MFH project such as a maintenance workshop, storage facilities, office, and living quarters for a resident manager and other personnel.

(i) *Purchase and install equipment and appliances.* Funds may be used to purchase and install equipment and appliances affixed to the property as customary and appropriate for the area in which the housing is located.

(j) *Household furnishings (Section 514/516).* For farm labor housing sections 514 and 516 only, funds may be used to purchase household furnishings.

(k) *Initial operating capital.* Loan funds equal to 2 percent of total development cost or appraised value, whichever is less, may be used by a state or political subdivision thereof, Indian tribe, consumer cooperative, or any public or private nonprofit borrower who is not receiving low-income housing tax credits (LIHTC), to make the initial operating capital contribution required by § 3560.64. Other borrowers must use their own resources to make the required initial operating capital contribution and may not use loan funds for that purpose.

(l) *Builder's profit, overhead and general requirements.* Subject to the following limits, funds may be used for builder's profit, overhead and general requirements.

(1) Up to 10 percent of the construction contract may be used for builder's profit.

(2) Up to 4 percent of the construction contract may be used for general overhead.

(3) Up to 7 percent of the construction contract may be used for general requirements.

(m) *Legal, technical and professional services.* Funds may be used for the costs of legal, technical, and professional services related to the borrower's MFH project, including appraisals, environmental documentation, and construction plans and specifications.

(n) *Permit and application fees.* Funds may be used for required MFH permits and application fees.

(o) *Reimbursement to nonprofit organizations and public bodies.* Funds may be used to reimburse a nonprofit organization or public body for up to 2 percent of total development costs for section 515, or up to 4 percent of total development costs for off-farm labor housing, for costs that are reasonable and typical for the area, including:

(1) Development and packaging of a loan application and a MFH proposal; and

(2) Legal, technical, and professional fees incurred in the formation of the loan application and MFH proposal; or

(3) Technical assistance from another nonprofit organization to assist in the organization's formation and in the development and packaging of a loan application and MFH proposal.

(p) *Educational programs.* Funds may be used for educational programs related to owning and managing a cooperative housing project for the board of directors of a housing cooperative during the first year of the housing operation. Such funds will be available from the initial operating account. The amount of the funds disbursed will be subject to Agency approval and availability of financial resources from the project.

(q) *Interest and customary charges.* Funds may be used for interest accrued and customary charges necessary to obtain interim financing.

(r) *Purchase housing from an interim lender.* Funds may be used to purchase MFH from an interim lender that holds fee simple title to Agency-financed housing upon which construction commenced and a letter of commitment had been issued by the Agency but the original applicant for whom funds were obligated will not or cannot continue with construction of the housing. In order for the purchase to take place, there must be no outstanding unpaid obligations in connection with the housing.

(s) *Uniform Relocation Assistance and Real Property Acquisition Act of 1970.* Funds may be used for necessary costs incurred to comply with the Uniform

Relocation Assistance and Real Property Acquisition Act of 1970.

(i) *Demonstration programs.* With the RHS Administrator's approval, funds may be used to construct demonstration housing involving innovative units and systems which do not meet existing published standards, rules, regulations, or policies but meet the intent of providing affordable, decent, safe, and sanitary rural housing, and are consistent with the requirements of Title V of the Housing Act of 1949.

(u) *Conversion of section 502 properties.* In accordance with § 3560.506, loan funds may be used to finance the conversion of real estate owned units originally financed under section 502 of the Housing Act of 1949, to MFH authorized by section 515 of the Housing Act of 1949.

**§ 3560.54 Restrictions on the use of funds.**

(a) *Ineligible uses of funds.* Funds may not be used for:

(1) Housing intended to serve temporary and transient residents, with the exception of housing to serve migrant farm workers in accordance with § 3560.554;

(2) Special care facilities or institutional-type homes;

(3) Facilities which are not in compliance with the design requirements specified in § 3560.60;

(4) Any costs associated with space in a housing project that is leased for commercial use or any commercial facilities except essential service-type facilities when otherwise not conveniently available;

(5) Specialized equipment for training and therapy;

(6) Operating capital for a central dining facility or any items which do not become affixed to the real estate security with the exception of household furnishings for farm labor housing units financed under sections 514 and 516;

(7) Compensation to a loan applicant for value of land contributed in excess of the equity contribution requirements in § 3560.63(c);

(8) Refinancing of an applicant's debt except when the debt involves interim financing or when refinancing is necessary to obtain a release of an existing lien on land owned by a nonprofit organization;

(9) Payment of any fee, charge, or commission to a broker or anyone else as a developer's fee or for referral of a prospective loan applicant or solicitation of a loan;

(10) Payment to any officer, director, trustee, stockholder, member, or agent of an applicant; or

(11) Purchasing land for a site in excess of what is needed, except when:

(i) The applicant cannot acquire an alternate site or cannot acquire the needed land as a separate parcel;

(ii) The applicant agrees to sell the excess land as soon as practical and to apply the proceeds to the loan; and

(iii) Program site density requirements are met in accordance with the site requirements established under § 3560.58.

(b) *Obligations incurred before loan approval.* Funds may not be used for expenses incurred by an applicant prior to approval except when all the following conditions are met:

(1) The debts were incurred for eligible purposes;

(2) Contracts, materials, construction, and any land purchased meet Agency standards and requirements;

(3) Payment of the debts will remove any attached liens and any basis for liens that may attach to the property on account of such debts; and

(4) The appropriate level of environmental review in accordance with 7 CFR part 1940, subpart G has been completed.

**§ 3560.55 Applicant eligibility requirements.**

Applicants for off-farm labor housing loans and grants should also refer to § 3560.555, and applicants for on-farm labor housing loans should refer to § 3560.605.

(a) *General.* To be eligible for Agency assistance, applicants must meet the following requirements:

(1) Be a U. S. citizen or qualified alien(s); a corporation; a state or local public Agency; an Indian tribe as defined in § 3560.11; or a limited liability company (LLC), nonprofit organization, consumer cooperative, trust, partnership, or limited partnership in which the principals are U.S. citizens or qualified aliens;

(2) Be unable to obtain similar credit elsewhere at rates that would allow for rents within the payment ability of eligible residents;

(3) Possess the legal and financial capacity to carry out the obligations required for the loan or grant;

(4) Be able to maintain, manage, and operate the housing for its intended purpose and in accordance with all Agency requirements;

(5) With the exception of applicants who are a nonprofit organization, housing cooperative or public body, be able to provide the borrower contribution from their own resources (this contribution must be in the form of cash, or land, or a combination thereof);

(6) Have or be able to obtain a minimum of 2 percent of the total development costs for use as initial

operating capital (for nonprofit organizations, cooperatives, or public bodies, this amount may be financed through Agency funds); and

(7) Not be suspended, debarred, or excluded based on the "List of Parties Excluded from Federal Procurement and Nonprocurement Programs." The list is available to Federal agencies from the U.S. Government Printing Office. Non-federal parties should contact the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, (202) 512-1800.

(8) Not delinquent on Federal debt or a Federal judgment debtor, with the exception of those debtors described in § 3560.55 (b).

(b) *Additional requirement for applicants with prior debt.* If an applicant or the managing general partner of a borrower, as well as any affiliated entity having a 10 percent or more ownership interest, has a prior or existing Agency debt, the following additional requirements must be met.

(1) The applicant must be in compliance with any existing loan or grant agreements and with all legal and regulatory requirements or must have an Agency-approved workout agreement and be in compliance with the provisions of the workout agreement. The Agency may require that applicants with monetary or non-monetary deficiencies be in compliance with an Agency-approved workout agreement for a minimum of 6 consecutive months before becoming eligible for further assistance.

(2) The applicant must be in compliance with the Title VI of the Civil Rights Act of 1964, section 504 of the Rehabilitation Act of 1973, and all other applicable civil rights laws.

(c) *Additional requirements for nonprofit organizations.* In addition to the eligibility requirements of paragraphs (a) and (b) of this section, nonprofit organizations must meet the following criteria:

(1) The applicant must have received a tax-exempt ruling from the IRS designating the applicant as a 501(c)(3) or 501(c)(4) organization.

(2) The applicant must have in its charter the provision of affordable housing.

(3) No part of the applicant's earnings may benefit any of its members, founders, or contributors.

(4) The applicant must be legally organized under state and local law.

(5) In the case of off-farm labor housing loans and grants, nonprofit organizations must be "broad-based" nonprofit organizations (refer to § 3560.555(a)(1)).

(d) *Additional requirements for limited partnerships.* In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, limited partnership loan applicants must meet the following criteria:

(1) The general partners must be able to meet the borrower contribution requirements if the partnership is not able to do so at the time of loan request.

(2) The general partners must maintain a minimum 5 percent financial interest in the residuals or refinancing proceeds in accordance with the partnership organizational documents.

(3) The partnership must agree that new general partners can be brought into the organization only with the prior written consent of the Agency.

(e) *Additional requirements for Limited Liability Companies (LLCs).* In addition to the applicant eligibility requirements of paragraphs (a) and (b) of this section, LLC loan applicants must meet the following criteria:

(1) One member who holds at least a 5 percent financial interest in the LLC must be designated the authorized agent to act on the LLC's behalf to bind the LLC and carry out the management functions of the LLC.

(2) No new members may be brought into the organization without prior consent of the Agency.

(3) The members must commit to meet the equity contribution requirements if the LLC is not able to do so at the time of loan request.

**§ 3560.56 Processing section 515 housing proposals.**

Processing requirements for farm labor housing proposals are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) *Notice of Funding Availability (NOFA) responses.* (1) The Agency will publish an annual NOFA with deadlines and other information related to submission of new construction MFH proposals, including expansion of existing MFH in designated places selected in accordance with § 3560.57.

(2) To be eligible for funding consideration, MFH proposals must be submitted in accordance with the NOFA and must provide information requested in the NOFA for the Agency to score and rank the proposals.

(3) MFH proposals needing rental subsidies must include requests for Agency rental assistance or a description of any non-Agency rental subsidy to be used with the proposal and must provide information required by § 3560.260 (c).

(4) The Agency will consider housing proposals requesting rental assistance in rank order to the extent rental assistance

is available. When there is no rental assistance available, the Agency will consider only those housing proposals in rank order that do not require rental assistance.

(b) *Preliminary proposal assessment.* The Agency will make a preliminary assessment of the application using the following criteria and will reject those applications which do not meet all of these criteria:

(1) The proposal was received by the submission deadline specified in the NOFA,

(2) The proposal is complete as specified in the NOFA,

(3) The proposal is for an authorized purpose, and

(4) The applicant meets Agency eligibility requirements.

(c) *Scoring and ranking project proposals.* The Agency will score and rank each housing proposal that meets the criteria of paragraph (b) of this section.

(1) The following criteria will be used to score housing proposals as more completely established in the NOFA:

(i) The presence and extent of leveraged assistance in the proposal for the units that will serve tenants meeting Agency income limits at basic rents comparable to what the rent would be if the Agency provided full financing.

(ii) The proposal will provide rental units in a colonia, tribal land, Rural Economic Area Partnership (REAP) community, Enterprise Zone or Empowerment Community (EZ/EC) or in a place identified in the state Consolidated Plan or a state needs assessment as a high need community for MFH.

(iii) The proposal supports Agency initiatives announced in the NOFA.

(iv) The proposal uses a donated site which meets the following conditions:

(A) The site is donated by a state, unit of local government, public body or a nonprofit organization;

(B) The site is suitable for the housing proposals and meets Agency requirements;

(C) Site development costs do not exceed what they would be to purchase and develop an alternative site;

(D) The overall cost of the MFH is reduced by the donation of the site; and

(E) A return on investment is not paid to the borrower for the value of the donated site nor is the value of the site considered as part of the borrower's contribution.

(2) The Agency will rank housing proposals based on their scoring.

(i) When proposals have an equal score, preference will be given to Indian tribes as defined in § 3560.11 and local nonprofit organizations or public bodies

whose principal purposes include low-income housing that meet the conditions of § 3560.55(c) and the following conditions.

(A) Is exempt from Federal income taxes under section 501(c)(3) or 501(c)(4) of the Internal Revenue code;

(B) Is not wholly or partially owned or controlled by a for-profit or limited-profit type entity;

(C) Whose members, or the entity, do not share an identity of interest with a for-profit or limited-profit type entity;

(D) Is not co-venturing with another entity; and

(E) The entity or its members will not be receiving any direct or indirect benefits pursuant to LIHTC.

(ii) A drawing will be held in the event of a tie score, first for proposals from applicants who meet the conditions of paragraph (c)(2)(i) of this section and next for proposals from applicants for which paragraph (c)(2)(i) of this section is not applicable. Each proposal will be numbered in the order in which it is drawn.

(3) The Agency will request initial loan applications from parties who submitted the housing proposals with the highest ranking, taking into consideration available funds. The Agency will notify non-selected parties with the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(d) *Processing initial loan applications.* The Agency will review all initial loan applications submitted in accordance with Agency requirements to further evaluate the eligibility and feasibility of the housing proposals. This determination will include:

(1) A review of the preliminary plans and cost estimates,

(2) A market feasibility review,

(3) An Agency site visit to gather preliminary environmental information and determine that the proposed site meets the site requirements of § 3560.58,

(4) A review of the Affirmative Fair Housing Marketing Plan,

(5) An analysis of current credit reports,

(6) A review of Civil Rights Impact Analysis in accordance with 7 CFR part 2006, subpart P, and

(7) Completion of the appropriate level of environmental review in accordance with 7 CFR part 1940, subpart G.

(e) *Processing order of initial loan applications.* The Agency will process initial loan applications in rank order, taking into account available funds. If any initial loan applications are withdrawn, rejected, or delayed for a period of time that will not permit funding in the current funding cycle,

the Agency will process, in rank order, the next initial loan application as funding levels permit.

(f) *Other assistance.* During each stage of loan application processing, loan applicants must notify the Agency of all other assistance, including other Federal Government assistance proposed or approved for use in connection with the loan application.

(g) *Proposal withdrawal or rejection.* An applicant may withdraw a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process with a written request. The Agency may reject a housing proposal, an initial loan application, or a final loan application at any time during the Agency review process when an applicant fails to provide information requested by the Agency within the time frame specified by the Agency.

(h) *Final applications.* Applicants, with initial loan applications that are selected by the Agency for further processing, must submit a final application, with any additional information requested by the Agency, to confirm and document a housing proposal's eligibility and feasibility, including an affirmative fair housing marketing plan. The Agency will notify applicants with initial loan applications that are not selected for further processing of their non-selection, the reasons for their non-selection, and the process that may be used to seek a review of the non-selection decision.

(i) *Rural cooperative housing proposals.* Rural cooperative housing loan proposals will be solicited through a NOFA and will be assessed and processed in the same manner described in paragraphs (a) through (h) of this section.

**§ 3560.57 Designated places for section 515 housing.**

(a) *Establish a list of designated places.* The Agency will establish a list of designated places from which loan proposals will be accepted. The list is updated each fiscal year and is available when the NOFA is published. The NOFA provides information on obtaining the list. This list will be developed from a list of rural places which the Agency identifies as having the greatest need for multifamily housing based on the following factors:

- (1) Qualification as a rural area as defined in § 3560.11,
- (2) Lack of mortgage credit, and
- (3) Demonstrated need for MFH based on:

- (i) The incidence of poverty,
- (ii) The existence of substandard housing,

(iii) The lack of affordable housing, and

(iv) The following high need areas:  
(A) Places identified in the state Consolidated Plan or similar state plan or needs assessment report,

(B) Indian reservations or communities located within the boundaries of tribal allotted or trust land, and

(C) EZ/EC or REAP communities.

(b) *Establishing partnership designated place list.* The Agency, in states with an active leveraging program and formal partnership agreement with the state agency, may establish a partnership designated place list consisting of places identified by the partnership as high need areas based on criteria consistent with the Agency's and the state's authorizing statutes. The partnership agreement and partnership designated place list must have the concurrence of the Administrator.

(c) *Administrator's discretion.* The Administrator may add to the list of designated places any place that is determined to have a compelling need for MFH, for example, a place that has had a substantial increase in population not reflected in the most recent census data, or a place that has experienced a loss of affordable housing because of a natural disaster.

(d) *Restrictions on loans in certain designated places.*

(1) Initial loan applications will not be requested and final loan applications will not be closed for housing proposals in designated places where any of the following conditions exist:

(i) The Agency has selected another MFH proposal in the designated place for processing.

(ii) A previously funded Agency, the U.S. Department of Housing and Urban Development (HUD), low-income housing tax credit or other similar assisted MFH in the designated place has not been completed or has not reached projected occupancy levels.

(iii) Existing assisted MFH in the designated place is experiencing high vacancy levels.

(iv) A special note rent or other loan servicing tool is pending or in effect for other assisted housing in the designated place, or

(v) The need in the market area is for additional rental assistance and not additional rental units.

(2) Exceptions to the provisions in § 3560.57(d)(1) may be made:

(i) When a group home is proposed for persons with disabilities in an area where the existing MFH is insufficient or unavailable for their needs; or

(ii) There is a compelling need for additional MFH, for example when the

units that have been approved or are under development represent only a small portion of the total units needed in the community.

**§ 3560.58 Site requirements.**

(a) *Location.* (1) New construction section 515 loans will be made only in designated places selected by the Agency in accordance with the requirements of § 3560.57.

(2) Agency-financed MFH must be located in residential areas as part of established rural communities, except as permitted in § 3560.58(b), and for farm labor housing units financed under sections 514 and 516, which may be developed in any area where a need for farm labor housing exists.

(3) Communities in which Agency-financed MFH is located must have adequate facilities and services to support the needs of tenants.

(4) Housing complexes will not be located in areas where there are undesirable influences such as high activity railroad tracks; adjacent to or near industrial sites; bordering sites or structures which are not decent, safe, or sanitary; or bordering sites which have potential environmental concerns such as processing plants. Sites which are not an integral part of a residential community and do not have reasonable access, either by location or terrain, to essential community facilities such as water, sewerage removal, schools, shopping, employment opportunities, medical facilities, may not be acceptable. Consistent with Federal law and Departmental Regulation, the Agency must conduct an environmental assessment and a civil rights impact analysis before a site can be accepted. Sites may be determined by the Agency to be unacceptable if any of the adverse conditions described in this paragraph exist.

(b) *Structures located in central business areas.* The Agency will consider financing construction or the purchase and substantial rehabilitation of an existing structure located in the central business area of a rural community. With prior consent from the Agency, a portion of such a structure may be designated for commercial use on a lease basis. RHS funds may not be used to finance any cost associated with the commercial space.

(c) *Site development costs and standards.* The cost of site development must be less than or comparable to the cost of site development at other available sites in the community and the site must be developed in accordance with 7 CFR part 1924, subpart C and any applicable standards imposed by a state or local government.

(d) *Densities.* Allowable site densities will be determined based on the following criteria:

(1) Compatibility and consistency with the community in which the MFH is located;

(2) Impact on the total development costs; and

(3) Size sufficient to accommodate necessary site features.

(e) *Flood or mudslide-prone areas.* (1) The Agency will not approve sites subject to 100-year floods when non-floodplain sites exist. The environmental review process will assess the availability of a reasonable site outside the 100-year floodplain.

(2) Sites located within the 100 year floodplain are not eligible for federal financial assistance unless flood insurance is available through the National Flood Insurance Program (NFIP). The Agency will complete Federal Emergency Management Agency (FEMA) Form 81-93, Standard Flood Hazard Determination, to document the site's location in relation to the floodplain and the availability of insurance under NFIP.

#### § 3560.59 Environmental requirements.

Under the National Environmental Policy Act, the Agency is required to assess the potential impact of the proposed action on protected environmental resources. Measures to avoid or at least mitigate adverse impacts to protected resources may require a change in the site or project design. Therefore, a site cannot be approved until the Agency has completed the environmental review in accordance with 7 CFR part 1940, subpart G, or any successor regulation. Likewise, the applicant should be informed that the environmental review must be completed and considered before the Agency can make a commitment of resources to the project.

#### § 3560.60 Design requirements.

(a) *Standards.* All Agency-financed MFH will be constructed in accordance with 7 CFR part 1924, subpart A and will consist of two or more rental units plus appropriate related facilities. Single family structures may be used for group homes and cooperative housing. Also, manufactured homes may be used to create MFH and single family housing originally financed through section 502 of the Housing Act of 1949 may be converted to MFH. Maintenance requirements are listed in § 3560.103(a)(3).

(b) *Residential design.* All MFH must be residential in character, except as provided for in § 3560.58(b), and must meet the needs of eligible residents.

(c) *Economical construction, operation and maintenance.* Taking into consideration life-cycle costs, all housing must be economical to construct, operate, and maintain and must not be of elaborate design or materials.

(1) Economical construction means construction that results in housing of at least average quality with amenities that are reasonable and customary for the community and necessary to appropriately serve tenants.

(2) Economical operating and maintenance means housing with operational and maintenance costs that allow a basic rent structure less than or consistent with conventional rents for comparable units in the community or in a similar community except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case may the rent exceed 150% of the comparable rent for conventional unit rent level.

(3) In meeting the Agency objective of economical construction, operation and maintenance, housing proposals must:

(i) Contain costs without jeopardizing the quality and marketability of the housing;

(ii) Employ life-cycle cost analyses acceptable to the Agency to determine the types of materials which will reduce overall costs by lowering operation and maintenance costs, even though their initial costs may be higher; and

(iii) Provide assurances that costs will be reduced when the Agency determines that housing costs are not economical. If assurances cannot be provided, funding may be withdrawn.

(4) The housing proposal will give maximum consideration to energy conservation measures and practices.

(d) *Accessibility.* All housing will meet the following accessibility requirements.

(1) For new construction of MFH, at least 5 percent of the units (but not less than one) must be constructed as fully accessible units to persons with disabilities. The Uniform Federal Accessibility Standards (UFAS) will be followed. Individual copies of these standards are available from the Architectural and Transportation Barriers Compliance Board, 1331 F Street, NW, Suite 1000, Washington, DC 20004-1111, Telephone: (202) 272-0080, TTY: (202) 272-0082, e-mail address: [info@access-board.gov](mailto:info@access-board.gov). When calculating how many accessible units

are required, always round up to the next whole number to ensure the 5 percent requirement is met.

(2) For existing properties that do not have fully accessible units, the 5 percent requirement will apply when making substantial alterations as defined by UFAS. The UFAS defines substantial alteration as "alteration to any building or facility is to be considered substantial if the total cost for a twelve month period amounts to 50 percent or more of the full and fair cash value of the building \* \* \* UFAS further defines full and fair cash value as "the assessed valuation of a building or facility as recorded in the assessor's office of the municipality and as equalized at one hundred percent (100%) valuation, or the replacement cost, or the fair market value." The 5 percent rule will also apply to repair or renovation work on a single unit. For instance, if a unit is damaged by fire and extensive repair is necessary, to the extent possible the unit is to be converted to a fully accessible unit.

(3) The variety of bedroom quantities of fully accessible units will be comparable to the variety of bedroom quantities of units which are not fully accessible. Borrowers will not, however, be required to exceed the 5 percent requirement simply to have an accessible unit of each bedroom quantity. In addition, accessible units should be distributed throughout the complex so not to concentrate the units in one location.

(4) All MFH must meet:

(i) The accessibility requirements as contained in section 504 of the Rehabilitation Act of 1973;

(ii) The requirements of the Fair Housing Amendments Act of 1988;

(iii) The requirements of the Americans with Disabilities Act of 1990, as applicable; and

(iv) All other Federal, State, and local requirements. When architectural standards differ, the most stringent standard will be followed.

#### § 3560.61 Loan security.

(a) *General.* Each loan made by the Agency will be secured in a manner that adequately protects the financial interest of the Federal Government throughout the period of the loan.

(b) *Lien position.* (1) The Agency will seek a first or parity lien position on Agency-financed property in all instances. The Agency may accept a junior lien position if the Federal Government's interests are adequately secured.

(2) The Agency will seek a first or parity lien on revenue from rent; Agency, HUD, state or private rental

subsidy payments; chattels; assignments; and operating and reserve accounts. The Agency will accept a junior lien position if the Federal Government's interests are adequately secured.

(c) *Liability.* Personal liability will be required of all individual borrowers. Personal liability will not be required for the members or stockholders of any corporation or trust or any partners in a limited partnership.

(d) *Housing and land ownership.* Applicants must own the MFH and related land for which the loan is being requested, or become the owner when the loan is closed or have a leasehold interest in the land. If an applicant is not the owner of the housing and the related land, the following conditions must be met prior to or at loan closing.

(1) A recorded mortgage on the improvements is given as collateral.

(2) The amount of the loan against the collateral does not exceed its estimated security value.

(3) The unexpired term of the lease on the date of loan closing is at least 50 percent longer than the term of the loan and rent charged for the lease does not exceed the rate being paid for similar leases in the area.

(4) The applicant's leasehold interest is not subject to summary foreclosure or cancellation.

(5) The lease permits:

(i) The Agency to foreclose the mortgage and to transfer the lease;

(ii) The Agency to bid at a foreclosure sale or to accept voluntary conveyance of the security in lieu of foreclosure;

(iii) The Agency to occupy the property, sublet the property, or sell the leasehold for cash or credit if the leasehold is acquired through foreclosure, if the Agency accepts voluntary conveyance in lieu of foreclosure, or if the borrower abandons the property; and

(iv) The applicant, in the event of default or inability to continue with the lease and the loan, to transfer the leasehold subject to the mortgage to a transferee that will assume the property ownership obligations.

#### **§ 3560.62 Technical, legal, insurance, and other services.**

(a) *Legal services.* Applicants must have written contracts for any legal services that are to be paid out of Agency loan funds.

(b) *Title clearance.* Applicants must obtain title clearance in accordance with the provisions of 7 CFR part 1927, subpart B applicable to title clearance, which would include title insurance or title opinion, unless the loan applicant is leasing the property or is an

organization or an individual with special title or loan closing problems, in which case title clearance and related legal services will be obtained in accordance with procedures approved by the Agency.

(c) *Architectural services.* Applicants must obtain a written contract for architectural services in accordance with the provisions of 7 CFR part 1924, subpart A.

(d) *Insurance.* Applicants must have property and liability coverage at loan closing as well as flood insurance, if needed. Fidelity coverage must be in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. At a minimum, applicants must meet the property, liability, flood, and fidelity insurance requirements in § 3560.105.

(e) *Surety bonding.* Applicants must comply with the surety bonding provisions of 7 CFR part 1924, subpart A.

#### **§ 3560.63 Loan limits.**

(a) *Determining the security value.* The security value for an Agency loan is the lesser of the total development cost (exclusive of any developer's fee as provided by paragraph (d)(2) of this section) or the housing project's security value as determined by an appraisal conducted in accordance with subpart P of this part, minus any prior or parity liens on the housing project. For purposes of determining security value:

(1) Total development cost must be calculated excluding costs not considered allowable under § 3560.54(a), and excluding costs related to compliance with the Uniform Relocation Assistance and Real Property Acquisition Act of 1970.

(2) The appraisal, which will determine the market value, subject to restricted rents, will be obtained by the Agency and conducted in accordance with subpart P of this part.

(b) *Limitations on loan amounts.* The Agency will not make any loans without adequate security. The following limitations will be set on loan amounts:

(1) For all loan applicants who will receive benefits from the low-income housing tax credit program, the amount of Agency financing for the housing will not exceed 95 percent of the security value available for the Agency loan.

(2) For all loan applicants who will not receive low-income housing tax credit benefits and who are comprised solely of nonprofit organizations, consumer cooperatives, or state or local public agencies, the amount of the loan will be limited to the security value

available for the Agency loan, plus the 2 percent initial operating capital and any necessary relocation costs incurred.

(3) For all other loan applicants who will not receive low-income housing tax credit benefits, the loan amount will be limited to no more than 97 percent of the security value available for the Agency loan.

(c) *Equity contribution.* Loan applicants, with the exception of nonprofit organizations, consumer cooperatives, or state or local public agencies who will not be receiving tax credits, must make an equity contribution from their own resources.

(1) Loan applicants who will receive benefits from the low-income housing tax credit program must make an equity contribution in the amount of 5 percent of the Agency loan. The maximum Agency loan will be determined in accordance with § 3560.63(b).

(2) Loan applicants who will not receive benefits from the low-income housing tax credit program and are not nonprofit organizations, consumer cooperatives, or state or local public agencies must make an equity contribution in the amount of 3 percent of the Agency loan. The maximum Agency loan will be determined in accordance with § 3560.63(b).

(d) *Review of assistance from multiple sources.* The Agency will analyze Federal Government and other assistance provided to any MFH project to establish the maximum loan amount and to assure that the assistance is not more than the minimum necessary to make the housing affordable, decent, safe, and sanitary to potential tenants.

(1) *Determining minimum assistance.* For purposes of determining minimum assistance, the total amount paid for builder's profit, overhead, and general requirements may not exceed 21 percent of the construction contract. Unless specified differently in a Memorandum of Understanding between the Agency and the state agency that allocates low-income housing tax credits, limits will be those specified in § 3560.53(l).

(2) *Developer's fee.* While, in accordance with § 3560.54(a)(9), payment of a developer's fee is not an eligible use of Agency loan funds, the Agency will include in total development costs a developer's fee paid from other sources when analyzing the Federal Government assistance to the housing. The Agency may recognize a developer's fee paid from other sources on construction or rehabilitation of up to 15 percent of the total development costs authorized for low-income housing tax credit purposes, or by another Federal Government program. Likewise for transfer proposals

that include acquisition costs, the developer's fee on the acquisition cost may be recognized up to 8 percent of the acquisition costs only when authorized under a Federal Government program providing assistance. The developer's fee is not included in determining the Agency's maximum debt limit and loan amount.

(e) *Limits on equity loans.* For equity loans to avert prepayment, the amount of the Agency equity loan will be limited to no more than the difference between 90 percent of market value of the property when appraised as conventional unsubsidized MFH and all current unpaid balances. For information on appraisal issues, refer to subpart P of this part.

(f) *Cost overruns.* (1) All applicants must agree in writing to provide funds at no cost to the housing and without pledging the housing as security to pay any cost for completing planned construction after the maximum debt limit is reached.

(2) After loan approval, the Agency will only approve cost increases for housing proposals involving new construction or major rehabilitation when the additional costs will not cause the limits specified in § 3560.53(l) or the maximum debt limit to be exceeded and the cost increases were caused by:

(i) Unforeseen factors that are determined by the Agency to be beyond the borrower's control;

(ii) Design changes required by the Agency, state, or the local government; or

(iii) Financing changes approved by the Agency.

**§ 3560.64 Initial operating capital contribution.**

Borrowers are required to make an initial operating capital contribution to the general operating account in the amount of at least 2 percent of the total development cost or appraised value, whichever is less.

(a) Borrowers that are nonprofit organizations, consumer cooperatives, or state or local public agencies and are not receiving low-income housing tax credits, may use loan funds for their initial operating capital contribution. All other borrowers must fund the initial operating capital contribution from their own resources.

(b) Borrowers must provide to the Agency for approval a list of materials and equipment to be funded from the general operating account for initial operating expenses. As specified in § 3560.304(b), initial operating capital may be used only to pay for approved budgeted expenses. If total initial operating expenses exceed 2 percent,

the additional amount must be paid by the borrower from its own resources, except that borrowers meeting the provisions of § 3560.64(a) who do not have sufficient resources for this purpose may request Agency assistance. Withdrawals from the reserve account will not be approved for such expenses.

(c) Borrowers must provide the Agency with documentation of their initial operating capital contribution deposited into the general operating account prior to the start of construction or loan closing, whichever comes first, and such funds thereafter, may only be used for authorized budgeted purposes.

(d) If the conditions specified in § 3560.304(c) are met, funds contributed as initial operating capital may be returned to the borrower.

**§ 3560.65 Reserve account.**

To meet major capital expenses of a housing project, borrowers must establish and fund a reserve account that meets requirements of § 3560.306. At a minimum, the borrower must agree to make monthly contributions to the reserve account at the rate of 1 percent annually of the amount of the total development cost until the reserve account equals 10 percent of the total development cost.

**§ 3560.66 Participation with other funding or financing sources.**

(a) *General requirements.* The Agency encourages the use of funding or financing from other sources in conjunction with Agency loans. When the Agency is not the sole source of financing for MFH, the following conditions must be met.

(1) The Agency will enter into a participation (or intercreditor) agreement with the other participants that clearly defines each party's relationship and responsibilities to the others.

(2) The rental units that will serve tenants eligible for housing under the Agency's income standards must meet Agency standards and the number of units that will serve the Agency's tenants are at least equal to the units financed by the Agency.

(3) All rental units must be operated and managed in compliance with the requirements of the Agency and the other sources. To the extent these requirements overlap, the most stringent requirement must be met. The Agency may negotiate the resolution of overlapping requirements on a case-by-case basis; however, at a minimum, Agency requirements must be met.

(4) If the number of units subject to the LIHTC rent and income restrictions is greater than the number of units

projected to receive Agency rental assistance (RA) or similar tenant subsidy, the market feasibility documentation must clearly reflect a need and demand by LIHTC income-eligible households financially able to afford the projected rents without such a subsidy for the units not receiving RA or similar tenant subsidy.

(b) *Rental assistance.* The Agency may provide rental assistance with MFH loans participating with other sources of funding under the following conditions:

(1) The Agency's loan equals at least 25 percent of the housing's total development cost.

(2) The rental assistance is provided only to those rental units where the basic rents do not exceed what basic rents would have been had the Agency provided full financing.

(3) The provisions of subpart F of this part are met.

(c) *Security requirements.* The security requirements of § 3560.61 must be met for all Agency-financed MFH participating with other sources of funding.

(d) *Reserve requirements.* Reserve account requirements will be determined on a case-by-case basis, taking into consideration the reserve requirements of the other participating lenders, so that the aggregate fully funded reserve account is consistent with the requirements of § 3560.65. Reserve requirements and procedures for reserve account withdrawals must be agreed upon by all lenders and included in the intercreditor or participation agreement.

(e) *Design requirements.* Housing and related facilities must be planned and constructed in accordance with 7 CFR 1924, subparts A and C. If housing includes non-Agency financed common facilities, the following conditions must be met:

(1) The non-Agency-financed common facility's operating and maintenance costs must be paid through collection of a user fee from residents who use the facility,

(2) The non-Agency-financed common facility must be designed and operated with appropriate safeguards for the health and safety of tenants, and

(3) The facility must be fully available and accessible to all tenants.

**§ 3560.67 Rates and terms for section 515 loans.**

Rates and terms for farm labor housing loans are found in subpart L of this part for Off-Farm and subpart M of this part for On-Farm.

(a) *Interest.* Loans will be closed at the lower of the interest rate in effect at the time of loan approval or the interest rate that is in effect at time of loan closing.

(b) *Interest credit.* The Agency will provide interest credit to subsidize the interest on the Agency loan to a payment rate of 1 percent for all of the Agency's initial and subsequent loans.

(c) *Amortization period and term.* (1) Except for manufactured housing, loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed 30 years from the date of loan. The Agency may make a loan to the borrower to finance the final payment of a loan in accordance with § 3560.74.

(2) Loans for manufactured housing will be amortized and paid over a term not to exceed 30 years as specified in § 3560.70(c).

**§ 3560.68 Permitted return on investment (ROI).**

(a) *Permitted return.* Borrowers operating on a limited profit basis will be permitted a return not to exceed 8 percent of their required initial investment determined at the time of loan approval in accordance with § 3560.63(c).

(b) *Calculation of permitted return.* The permitted return will be based on the borrower's contributions from their own resources, which, when added to the Agency loan amount and all sources of funding or financing, do not exceed the security value of the MFH project as specified in § 3560.63(a).

(1) Proceeds received by the borrower from the syndication of low-income housing tax credit and contributed to the MFH project may be considered funds from the borrower's own resources for the portion of the proceeds which exceeds:

(i) The allowable developer's fee determined by the state agency administering the low-income housing tax credit, and

(ii) The borrower's expected contribution to the transaction, as determined by the state agency administering the low-income housing tax credit.

(2) A building site contributed by the borrower will be appraised by the Agency to determine its market value. A return may not be allowed on the amount above the equity contribution required by § 3560.63(c) if the market value as determined by the Agency, when added to the loan and grant amounts from all sources, exceeds the security value of the MFH project as specified in § 3560.63(a).

(c) *Return on additional investment.* The initial investment may exceed the equity contribution required by § 3560.63(c) and a return allowed on the investment if the additional return does

not increase basic rents and rental assistance costs above what basic rents and rental assistance costs would have been with the Agency financing 95 or 97 percent of the total development cost.

(d) *Compensation to nonprofit organizations.* Although nonprofit organizations are not eligible to take a return on investment, with prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities, as described in § 3560.303(b)(1)(ii).

**§ 3560.69 Supplemental requirements for congregate housing and group homes.**

(a) *General.* Congregate housing and group homes must be planned and developed in accordance with 7 CFR part 1924, subparts A and C.

(b) *Design criteria.* Congregate housing and group homes must be designed to accommodate all special services that will be provided.

(c) *Services.* Congregate housing and group home loan applicants, as part of their loan request, must submit a plan to make affordable services available to residents to assist the residents in living independently. The plan must address the availability of this assistance from service providers throughout the term of the loan.

(1) For congregate housing, the resident services plan must address how the following services will be provided or made available:

(i) One cooked meal per day, seven days per week;

(ii) Transportation to and from the property;

(iii) Assistance in housekeeping;

(iv) Personal services;

(v) Recreational and social activities; and

(vi) Access to medical services.

(2) For group homes, the resident services plan must address how access to the following services will be provided or made available:

(i) A common kitchen in which to prepare meals;

(ii) Transportation;

(iii) Nearby recreational and social activities which may be coordinated by the resident assistant, if applicable; and

(iv) Medical services as necessary.

(d) *Necessary items.* Borrowers must ensure items such as tables, chairs, and cookware necessary to furnish common areas are made available to congregate housing or group homes. The 2 percent initial operating capital may be used to purchase these items.

(e) *Association with other organizations.* Congregate housing and group homes may coordinate services or

training with another organization, such as a workshop for the developmentally disabled. However, the housing facility must be a separate entity and not dependent on the other organization.

(f) *Market feasibility documentation.* Market feasibility documentation for congregate housing and group homes is subject to the following requirements:

(1) Must address the need for housing with services and include information concerning alternative service providers;

(2) Must contain demographic information pertaining to the population that is to be served by the congregate housing or group home project; and

(3) May consider an expanded market area that includes nondesignated places, but the facility must be located in a designated place.

(g) *Rental assistance for group homes.*

A unit in a group home consists of a space occupied by a specific tenant household, which may be an apartment unit, a bedroom, or a part of a bedroom. Agency rental assistance will be made available to tenants sharing a unit so long as the total rent for the unit does not exceed conventional rents for comparable units in the area or a similar area.

**§ 3560.70 Supplemental requirements for manufactured housing.**

(a) *Design requirements.*

Manufactured housing must meet the requirements of 7 CFR part 1924, subpart A applicable to manufactured housing.

(b) *Eligible properties.* The manufactured housing must include two or more housing units. The applicant will become the first owner purchasing the manufactured homes for purposes other than resale. The following exceptions may be made to this provision:

(1) A housing proposal may include the purchase of the real property with existing manufactured housing which will be redeveloped with the placement of new manufactured homes.

(2) A housing proposal may include the rehabilitation of existing manufactured housing only if the units to be rehabilitated are currently financed by the Agency. The proposal will include the results of the applicant's consultation with the manufacturer to determine if the proposed rehabilitation work will affect the structural integrity of the unit and, if so, the statement will include an explanation as to how.

(c) *Terms.* The maximum loan amount will be determined in accordance with the requirements of § 3560.63. The amortization period and term of loans

for manufactured housing will not exceed the lesser of the economic life of the housing being financed or 30 years.

(d) *Security.* A mortgage or deed of trust will be taken on the entire property purchased or improved with the loan.

The encumbered property must be covered under a standard real estate title insurance policy or attorney's title opinion that identifies the housing as real property and insures or indemnifies against any loss if the manufactured home is determined not to be part of the real property. The property must be taxed as real estate by the jurisdiction where the housing is located if such taxation is permitted under applicable law when the loan is closed.

(e) *Special warranty requirements.*

The general contractor or dealer-contractor, as applicable, must provide a warranty in accordance with the provisions of 7 CFR part 1924, subpart A.

(1) The warranty must establish that the manufactured homes, foundations, positioning and anchoring of the units to their permanent foundations, and all contracted improvements, are constructed in conformity with applicable approved plans and specifications.

(2) The warranty must include provisions that the manufactured homes sustained no hidden damage during transportation and, for double-wide units, that the sections were properly joined and sealed.

(3) The general contractor or dealer contractor must warrant that the manufacturer's warranty is in addition to and does not diminish or limit all other warranties, rights, and remedies that the borrower or lender may have.

(4) The seller of the manufactured homes must deliver to the borrower the manufacturer's warranty with an additional copy for RHS. The warranty must identify the units by serial number.

#### § 3560.71 Construction financing.

(a) *Construction financing plan.* Prior to loan approval, applicants must submit to the Agency for its concurrence a plan for the construction financing and securing of the loan.

(b) *Interim financing.* Interim financing is required by the Agency for any construction, except as noted in paragraph (c) of this section.

(1) The Agency reserves the right to review and approve the interim financing arrangements proposed by the applicant.

(2) When interim financing is used, the Agency will obligate the funds and provide an interim financing letter to the lender that will confirm the

procedures and conditions for the construction financing. The take-out loan will be closed and the interim lender paid off when the conditions of the interim financing letter have been met.

(3) The applicable provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(4) An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, prior to issuance of the interim financing letter.

(c) *Multiple advances.* When interim financing is not available or when it is in the best interest of the Federal Government, the Agency may provide for multiple advances of the funds to cover the cost of construction.

(1) The Agency will review and approve the multiple advances proposed by the borrower.

(2) When multiple advances are used, the Agency will close the loan prior to any advancement of funds and the relevant provisions of 7 CFR part 1924, subpart A will be used to monitor the construction.

(3) The loan check will be handled in accordance with 7 CFR part 1902, subpart A.

#### § 3560.72 Loan closing.

(a) *Requirements.* Loans will be closed in accordance with 7 CFR part 1927, subpart B and any state supplements. In all cases, the borrower must:

(1) Provide evidence that an Agency-approved accounting system is in place;

(2) Execute a restrictive-use contract acceptable to the Agency that establishes the borrower's obligation to operate the housing for program purposes for the term of the Agency loan;

(i) For all section 514 loans, except as provided in § 3560.621, made pursuant to a contract entered into on or after the effective date of this regulation, the following language will be included in the mortgage and deed of trust: "The borrower and any successors in interest agree to use the housing for the purpose of housing people eligible for occupancy as provided in sections 514 and 516 of title V of the Housing Act of 1949, and Rural Housing Service regulations then in effect. The restrictions are applicable for a term of 20 years from the date on which the last loan was closed. No eligible person occupying the housing will be required to vacate nor any eligible person denied occupancy for housing prior to the close of such period because of a prohibited change in the use of the housing. A tenant or person wishing to occupy the housing may seek

enforcement of this provision as well as the Government."

(ii) All other loans are subject to restrictive-use provisions as outlined in subpart N of this part.

(3) Provide evidence that construction financing arrangements are adequate when interim financing is going to be used;

(4) Provide evidence that all the funds from other sources as proposed in the application are available and that there have been no changes in the Sources and Uses Comprehensive Evaluation (SAUCE).

(5) Provide evidence of the title to all security required by the Agency;

(6) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be paid;

(7) Provide, in the case of interim financing, a dated and signed statement from the owner's architect certifying to substantial completion of the housing project;

(8) Provide a certification that all construction in the case of interim financing has been or, in the case of multiple advances, will be in accordance with the plans and specifications concurred in by the Agency;

(9) Provide evidence, if applicable, that the conditions of the interim financing letter have been met; and

(10) Attend a pre-occupancy conference with the Agency.

(b) *Cost certification.* In all cases, the borrower must report actual construction costs. Whenever the State Director determines it appropriate, and in all situations where there is an identity of interest as defined in 7 CFR 1924.4 (i), the borrower, contractor and any subcontractor, material supplier, or equipment lessor having an identity of interest must each provide certification as to the actual cost of the work performed in connection with the construction contract in accordance with 7 CFR part 1924, subpart A. The construction costs must also be audited in accordance with Governmental Auditing Standards, by a Certified Public Accountant (CPA). In some cases, the Agency will contract directly with a CPA for the cost certification. Funds that were included in the loan for cost certification and which are ultimately not needed because Agency contracts for the cost certification will be returned on the loan. Agency personnel will utilize exhibit M of 7 CFR part 1924, subpart A to assist in the evaluation of the cost certification process.

(c) *Notification of loan cancellation.* Loans may be canceled after approval and before loan closing. The Agency

will notify all parties of the cancellation and the reasons for the cancellation in accordance with 7 CFR part 1927, subpart B.

**§ 3560.73 Subsequent loans.**

(a) *Applicability.* The Agency may make a subsequent loan to a borrower to complete, improve, repair, or make modifications to MFH initially financed by the Agency or for equity for preservation purposes. Loan requests to add units to comply with accessibility requirements may be processed as a subsequent loan; however, loan requests to add units to meet market demand will be processed as an initial loan request and must compete under the NOFA.

(b) *Application requirements and processing.* Upon receipt of a subsequent loan request, the Agency will inform the applicant what information is required based on the nature and purpose of the loan request. Subsequent loan requests do not have to compete for funding against initial loan proposals.

(c) *Amortization and payment period.* Subsequent loans will be amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years and paid over a term not to exceed the lesser of the economic life of the housing or 30 years from the date of the loan.

(d) *Equity contribution.* Applicants for subsequent loans must make contributions on the loans in the same proportion as outlined in § 3560.63(c). Loan applicants will not be given consideration for any increased equity value that the property may have since the initial loan.

(1) Excess initial investment on an initial loan may be credited toward the required investment on a subsequent loan.

(2) An initial operating capital contribution to the general operating account as described in § 3560.64 is required for a subsequent loan approved under the conditions set in § 3560.63(f) to complete housing construction but is not required for a subsequent loan to repair or improve existing housing.

(e) *Environmental requirements.* Subsequent loans are subject to the completion of an environmental review in accordance with 7 CFR part 1940, subpart G.

(f) *Design requirements.* All improvements, repairs, and modifications will be in accordance with 7 CFR part 1924, subparts A and C.

(g) *Architectural services.* The applicant must obtain architectural

services when any of the following conditions exist:

- (1) Enclosed space is being added,
- (2) When required by state law, and
- (3) When the Agency determines that the work being proposed requires architectural services.

(h) *Restrictive-use requirements.* Subsequent loans are subject to restrictive-use provisions as outlined in § 3560.662(a) and borrowers must execute a restrictive-use contract in accordance with § 3560.72(a)(2).

(i) *Designation changes from rural to nonrural.* If the designation of an area changes from rural to nonrural after the initial loan is made, a subsequent loan may be made only to make necessary improvements and repairs to the property or for equity when needed to avert prepayment.

(j) *Agency's discretion.* The Administrator may approve a subsequent loan in a place that is not on the list of designated places as a servicing action, for example, to replace units destroyed by a natural disaster.

**§ 3560.74 Loan for final payments.**

(a) *Use.* The Agency may finance final payments for borrowers holding existing loans for which the Agency approved an amortization period that exceeded the term of the loan.

(b) *Requirements.* The Agency may finance final payments if documentation regarding the market area shows that a need for low-income rental housing still exists for that area and one of the following conditions has been met.

(1) It is more cost efficient and serves the tenant base more effectively to maintain existing MFH than to build another property in the same location; or

(2) The MFH has been maintained to such an extent that it can be expected to continue providing affordable, decent, safe and sanitary housing for 20 years beyond the date of the loan to finance a final payment; and

(3) Funds are available.

(c) *Term.* The term of Agency loans to finance final payments will not exceed 20 years from the date of the initial loan final payment.

**§§ 3560.75–3560.99 [Reserved]**

**§ 3560.100 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response,

including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart C—Borrower Management and Operations Responsibilities**

**§ 3560.101 General.**

This subpart sets forth borrower obligations regarding management and operations of multi-family housing (MFH) projects financed by the Agency. As noted in § 3560.6, the borrower requirements listed in this subpart must be complied with by the borrower. The borrower may designate in writing a person to act as the borrower's authorized agent.

**§ 3560.102 Housing project management.**

(a) *General.* Borrowers hold final responsibility for housing project management and must ensure that operations comply with the terms of all loan or grant documents, Agency requirements and applicable local, state and Federal laws and ordinances. Project operations shall be conducted to meet the actual needs and necessary expenses of the property or for any other purpose authorized under Agency regulations. Any party not meeting these responsibilities may be subject to penalties. It is expected that only typical and reasonable expenses be incurred for the services rendered. Consequently, methods to inflate, duplicate, obscure, or failure to disclose the true nature and cost of work performed for the services rendered will cause the Agency to deny budget requests for the services or issue a demand for recovery and reimbursement for unauthorized actions.

(b) *Management plan.* Borrowers must develop and maintain a management plan for each housing project covered by their loan or grant. The management plan must establish the systems and procedures necessary to ensure that housing project operations comply with Agency requirements.

(1) At a minimum, management plans must address the following items:

(i) Maintenance systems, including procedures for routine maintenance, capital item repair and replacement, and effective energy conservation practices;

(ii) Personnel policies, job descriptions, staffing plans, training procedures for on-site staff. The Borrower will include specific duties

and responsibilities of each property manager, site manager and caretaker;

(iii) Front-line management functions to be performed by off-site staff;

(iv) Plans and procedures for providing supplemental services including laundry, vending, and security;

(v) Plans for accounting, record keeping and meeting Agency reporting requirements;

(vi) Procurement procedures;

(vii) Rent and occupancy charge collection procedures, and procedures for requesting and implementing changes in rents, utility allowances, or occupancy charges;

(viii) Plans and procedures for marketing rental units and maintaining compliance with the Affirmative Fair Housing Marketing Plan in accordance with § 3560.104;

(ix) Unit leases and leasing policies and procedures, including procedures for maintaining and purging waiting lists, determining applicant eligibility, certifying and recertifying income, tenant selection, and occupancy policies such as security deposit amounts, occupancy rules, termination of leases or occupancy agreements and eviction;

(x) Plans for allowing tenant participation in property operations and for fostering tenant relationships with management;

(xi) Procedures for applicant and tenant appeals; and

(xii) Describe how management will make known to tenants and applicants that management will provide reasonable accommodations under the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and regulations implemented thereunder at the borrower's expense unless to do so would cause an undue financial or administrative burden, how such requests are to be made, and who within management will have the authority to approve or disapprove a request for an accommodation.

(2) Loan or grant applicants must submit a management plan before the Agency will give final approval to the loan or grant application. The plan must address the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to monitor housing project performance.

(c) *Management plan effective period.* A management plan remains in effect as long as it accurately reflects housing project operations and the housing project is in compliance with the Agency requirements.

(1) Borrowers must submit an updated management plan to the Agency if operations change or are no longer

consistent with the management plan on file with the Agency.

(2) When there are no changes in operations, borrowers must submit a certification to the Agency every 3 years stating that operations are consistent with the management plan and the plan is adequate to assure compliance with the loan and grant documents and Agency requirements or applicable local, state and Federal laws.

(3) If the Agency determines that operations are in compliance with Agency requirements, loan or grant agreements, or applicable local, state, and Federal laws, but are not consistent with the management plan, the Agency will require the borrower to:

(i) Revise the management plan to accurately reflect housing operations;

(ii) Take actions to ensure the management plan is followed; or

(iii) Advise the Agency in writing of the action taken.

(4) When a housing project is being transferred from one borrower to another, the transferee must submit a management plan that addresses the required items identified in paragraph (b)(1) of this section in sufficient detail to enable the Agency to give final approval of the transfer.

(d) *Housing projects with compliance violations.* Upon receiving notice of compliance violations in accordance with § 3560.354, borrowers must submit to the Agency:

(1) Revisions to the management plan establishing the changes in housing operations that will be made to restore compliance;

(2) If the borrower determines the compliance violations were due to a failure to follow the management plan, the borrower must certify to the Agency that the management plan is adequate to assure compliance with the applicable requirements of this part and submit a written description of the actions they will take to ensure the management plan is followed; or

(3) If the Agency discovers continued discrepancies between a management plan and housing project operations or compliance violations, the Agency may require the borrower to install a different management agent acceptable to the Agency as described in paragraph (e) of this section.

(e) *Acceptable management agents.* Borrowers must obtain Agency approval of the agent proposed to manage a housing project prior to entering into any formal agreement with the agent and prior to allowing the agent to assume responsibility for housing project operations. Borrowers that plan to self-manage a housing project also must receive Agency approval before

assuming responsibility for housing operations.

(1) Borrowers must submit a written request for Agency approval of the proposed management agent at least 45 days prior to the date the agent is to assume responsibility for operations. This request must include a profile of the proposed management agent that provides sufficient information to allow the Agency to evaluate whether the agent is acceptable.

(2) The Agency will deny approval of any proposed management agent that cannot provide evidence of at least two years of experience and satisfactory performance in directing and overseeing the management of similar federally-assisted MFH.

(3) The Agency may issue approval of a management agent that does not meet the requirements of § 3560.102(e)(2) if the management agent can provide evidence that indicates the ability to successfully manage a MFH project in accordance with Agency requirements.

(4) If a borrower enters into an agreement with a management agent or begins to self-manage prior to receiving Agency approval, the Agency will place the borrower in non-monetary default status and will require the borrower to immediately terminate the contract with the management agent.

(f) *Self-management.* Borrowers may self-manage a housing project but must receive Agency approval before assuming responsibility for housing operations. Borrowers that plan to self-manage must meet all requirements of § 3560.102, except for paragraph (h) of this section.

(g) *Identity-of-interest disclosure.* Borrowers and management agents must disclose to the Agency all identity-of-interest relationships which they have with firms and must receive Agency approval to use such firms prior to entering into any contractual relationships with such entities that involve Agency funds.

(1) This disclosure must include any identity-of-interest relationships between:

(i) The borrower and the management agent;

(ii) The borrower or management agent and the providers of supplies and services to the housing project; and

(iii) The borrower or the management agent and employees of any of the above.

(2) Failure to disclose such relationships may subject the borrower, the management agent, and the other firms or employees found to have an identity of interest relationship to suspension, debarment, or other remedies available to the Agency.

(3) After disclosure of an identity-of-interest relationship:

(i) The borrower, management agent, and supplier of goods and services must provide documentation proving that use of identity-of-interest firms is in the best interest of the housing project;

(ii) Any supplier of goods and services must certify in writing to the Agency that the individual or organization has a viable, on-going trade or business qualified and licensed, if appropriate, to do the work for which a contract is being proposed;

(iii) The borrower, management agent, and supplier of goods and services must agree, in writing, that all records related to the housing project will be made available to the Agency, Office of the Inspector General (OIG), General Accountability Office (GAO), or a representative of the Agency, upon request; and

(iv) The Agency will deny the use of an identity-of-interest firm when the Agency determines such use is not in the best interest of the Federal Government or the tenants.

(h) *Management agreement.* Borrowers contracting with a management agent must execute a management agreement that establishes:

(1) The management agent's responsibility to comply with Agency requirements and local, state, and Federal laws;

(2) That the management fee is payable out of the housing project's general operating account consistent with the requirements of paragraph (i) of this section; and

(3) The Agency's authority to terminate the agreement for failure to operate the housing project in accordance with Agency requirements or local, state, or Federal laws.

(i) *Management fees.* Management fees will be an allowable expense to be paid from the housing project's general operating account only if the fee is approved by the Agency as a reasonable cost to the housing project and documented on the management certification. Management fees must be developed in accordance with the following:

(1) The management fee may compensate the management entity only for the specifically identified bundle of services to be provided to the housing project. Costs and services to be paid as part of the bundle of services include:

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

(ii) Hiring, supervision, and termination of on-site staff.

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

(iv) Training provided to on-site staff at the project site.

(v) Preparation and submission of proposed annual budgets and negotiation of approval with the Agency, other governmental agencies and the borrowers.

(vi) Preparation and distribution of the Agency or other governmental agency forms and routine financial reports to borrowers.

(vii) Preparation and distribution of required year-end reports to the Agency or other governmental agency and borrowers.

(viii) Preparation of requests for reserve withdrawals, rent increases, or other required adjustments.

(ix) Arranging for preparation by outside contractors of energy audits and utility allowance analysis. Implement appropriate changes.

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

(xi) Review of tenant certifications and submission of monthly rental assistance requests, and overage. Submission of payments where required.

(xii) Preparation, approval, and distribution of operating disbursements; oversight of project receipts; and reconciliation of deposits.

(xiii) Overhead of management agent, including:

(A) Establish, maintain, and control an accounting system sufficient to carry out accounting supervision responsibilities.

(B) Maintain agent office arrangements, staff, equipment, furniture, and services necessary to communicate effectively with the properties, the Agency or other governmental agency and with the borrowers.

(C) Postage expenses related to the normal responsibility for mailings to the properties, the Agency or other governmental agency, the tenants, the vendors, and the owners.

(D) Expense of telephone and facsimile communication to the properties, tenants, the Agency or other governmental agency, and the borrowers.

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

(F) Central office staff training and ongoing certifications.

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

(H) Insurance coverage for agent's office and operations (Property, Auto, Liability, E&O, Casualty, Workers Compensation, etc.)

(I) Travel of agent staff to the properties for on-site inspection, training, or supervision activities.

(J) Agent bookkeeping for their own business.

(xiv) Attendance at meetings (including travel) with tenants, owners, and the Agency or other governmental agency.

(xv) Development, preparation, and revision of management plans or agreements.

(xvi) Coordination of U.S. Department of Housing and Urban Development (HUD) certifications or vouchers with tenants, including all reporting to all pertinent agencies and borrowers.

(xvii) Directing the investment of project funds into required accounts.

(xviii) Maintenance of bank accounts and monthly reconciliations.

(xix) Preparation, request for, and disbursement of borrower's initial operating capital (for new projects) as well as administration of annual owner's return on investment.

(xx) Account maintenance, settlement, and disbursement of security deposits.

(xxi) Working with third party auditors for initial set-up of audits and annually thereafter for audit preparation and review. Assistance with supplemental letters and preparation of Agency financial reports or other governmental agency reports.

(xxii) Storage of records and adherence to records retention requirements.

(xxiii) Assist on-site staff with tenant relations and problems. Provide assistance to on-site staff in severe actions (eviction, death, insurance loss, etc.).

(xxiv) Oversight of general and preventive maintenance procedures and policies.

(xxv) Development and oversight of asset replacement plans.

(xxvi) Oversight of preparation of section 504 reviews, development of plans, and implementation of improvements necessary to comply with plans and section 504 requirements.

(xxvii) Reporting to general and limited partners and State agencies for Low Income Housing Tax Credit (LIHTC)-compliance purposes.

(2) Management fees may consist of a base per occupied unit fee and add-on fees for specific housing project characteristics. Management entities may be eligible to receive the full base per occupied unit fee for any month or part of a month during which the unit is occupied.

(i) Periodically, the Agency will develop a range of base per occupied unit fees that will be paid in each state. The Agency will develop the fees based on a review of housing industry data. The final base for occupied unit fees for each state will be made available to all borrowers.

(ii) Periodically, the Agency will develop the amount and qualifications to receive add-on fees. The final set of qualifications will be made available to all borrowers.

(3) Allowable Administrative Expenses. (i) *Identifying the Type of Administrative Expense.* Management Plans and Agreements must describe if administrative expenses are to be paid from the management fee or paid for as a project cost.

(A) A management plan is required for all projects. The management plan should describe administrative expenses paid from management agent fees or project operations. The management plan should provide job descriptions for the site manager, the management agent and other personnel. It is important that these documents accurately reflect the duties being performed by the various personnel. The management plan must meet the standards set out in this rule.

(B) A task list should be used to identify which services are included in the management fee, which services are included in project operations, and which are pro-rated along with the methodology used to pro-rating of expenses between management agent fees and project operations. Some property responsibilities are completed at the property and some offsite. Agent responsibilities may be performed at the property, the management office, or at some other location.

(C) Disputes may arise as to who performs certain services. The management plan and job descriptions should normally provide sufficient clarity to avoid or resolve any such disputes; however, sometimes clarifications and supporting materials may be required to resolve disputes. The decision must be made based on the most complete evaluation of the facts presented.

(ii) *Allowable Administrative Expenses.* Payroll related administrative expenses are allowable expenses. Postage expense to mail out rental applications, third-party (asset income and adjustments to income) verifications, application processing correspondence (acceptance or denial letters), mailing project invoice payments, required correspondence, and report submittals to various regulatory authorities for the managed property are allowable project expenses no matter what location or point of origin the mail is generated.

Photocopying or printing expense related to actual production of project brochures, marketing pieces, forms, reports, notices, and newsletters are allowable project expenses no matter what location or point of origin the work is performed including outsourcing the work to a professional printer. Correspondence or reports required for record retention or project compliance are allowable project expenses. The cost or expense of equipment and any related equipment service contract is a management agent direct expense, unless the machine becomes the property of the project after purchase.

(iii) *Determining if Expenses are Reasonable.* Generally, expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes. If such value is not apparent, the service or expense should be examined.

(A) Administrative expenses for project operations exceeding 23 percent, or those typical for the area, of gross potential basic rents and revenues (*i.e.*, referred to as gross potential rents in industry publications) highlight a need for closer review for unnecessary expenditures. Budget approval is required and project resources may not always permit an otherwise allowable expense to be incurred if it is not fiscally prudent in the market.

(B) Excessive administrative expenses can result in inadequate funds to meet other essential project needs, including expenditures for repair and maintenance needed to keep the project in sound physical condition. Actions that are improper or not fiscally prudent may warrant budget disapproval and/or a demand for recovery action.

(4) Unallowable Administrative Expenses.

(i) Certain expenses are not allowable such as legal fees, association dues,

bonuses or monetary performance awards, parties, computer hardware and some software, and telephone purchases.

(ii) It is inappropriate to charge for legal services to represent any interest other than the borrower's interest (*i.e.*, representing a general partner or limited partner to defend their individual owner interest is not allowable). Where there is no finding of a borrower's fault, commercially reasonable legal expenses and costs for defending or settling lawsuits (without admission of liability) are allowable.

(iii) Charging for payment of penalties, including opposition legal fees resulting from an award finding improper actions on the part of the owner or management agent is generally an inappropriate project expense. The party responsible generally pays such expenses for violating the standards or by their insurance carriers.

(iv) Association dues to be paid by the project should only be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ration, a reasonable expense may be billed to the project.

(v) It is inappropriate for the project to pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(vi) Billing the project for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff are also inappropriate.

(vii) It is inappropriate to bill the project for computer hardware, some software, and internal connections that are beyond the scope and size reasonably needed for the services supplied (*i.e.*, purchasing equipment or software for use by a site manager that is clearly beyond that needed to support project operations). Note that computer learning center activities benefiting tenants are not covered in this prohibition.

(viii) It is inappropriate to bill the project for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(j) *Management certification.* (1) As a condition of approval of the management agent and the management fee, the borrower and the management agents must execute an Agency-approved certification establishing an allowable management fee to be paid

out of the housing project's general operating account and certifying that:

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

(ii) The borrower and the management agent will comply with Agency requirements, loan or grant agreements, applicable local, state and Federal laws and ordinances, and contract obligations, will certify that no payments have been made to anyone in return for awarding the management contract to the management agent, and will agree that such payments will not be made in the future;

(iii) The borrower and the management agent will comply with Agency notices or other policy directives that relate to the management of the housing project;

(iv) The management agreement between the borrower and management agent complies with the requirements of this section;

(v) The borrower and the management agent will comply with Agency requirements regarding management fees as specified in paragraph (i) of this section, and allocation of management costs between the management fee and the housing project financial accounts specified in § 3560.302(c)(3);

(vi) The borrower and the management agent will not purchase goods and services from entities that have an identity-of-interest (IOI) with the borrower or the management agent until the IOI relationship has been disclosed to the Agency according to paragraph (g) of this section, not denied by the Agency under paragraph (d)(3) of this section, and it has been determined that the costs are as low as or lower than arms-length, open-market purchases; and

(vii) The borrower and the management agent agree that all records related to the housing project are the property of the housing project and that the Agency, OIG, or GAO may inspect the housing records and the records of the borrower, management agent, and suppliers of goods and services having an IOI with the borrower or with a management agent acting as an agent of the borrower upon demand.

(2) A certification will be executed each time a management agent is proposed and a management agreement is executed or renewed. Any amendment to a management certification must be approved by the Agency and the borrower.

(k) *Procurement.* The borrower and the agents of the borrower must obtain contracts, materials, supplies, utilities, and services at a reasonable cost and

seek the most advantageous terms to the housing project. Any discounts, rebates, fees, proceeds, or commissions obtainable with respect to purchases, service contracts, or other transactions must be credited to the housing project.

(l) *Electronic Submission of Data to Agency.* For properties with eight or more housing units, the Agency may specify that borrowers submit information required by this part electronically.

#### § 3560.103 Maintaining housing projects.

(a) *Physical maintenance.* (1) The purposes of physical maintenance are the following:

(i) Provide decent, safe, and sanitary housing; and

(ii) Maintain the security of the property.

(2) Borrowers are responsible for the long-term, cost-effective preservation of the housing project.

(3) At all times, borrowers must maintain housing projects in compliance with local, state and federal laws and regulations and according to the following Agency requirements for affordable, decent, safe, and sanitary housing. Agency design requirements are discussed in § 3560.60. The Agency acknowledges that property maintenance is an ongoing process and will not penalize borrowers for less than 100 percent compliance as long as it is evident that the borrower is striving to achieve the standards listed in this paragraph. In addition, the Agency understands that although its multifamily housing portfolio is relatively homogeneous, no one standard is appropriate for all properties.

(i) *Utilities.* The housing project must have an adequate and safe water supply, a functional and safe waste disposal system, and must be free of hazardous waste material.

(ii) *Drainage and erosion control.* The housing project must have drainage that effectively protects the housing project from water damage from standing water and erosion. Units, basements, and crawl spaces must be free of water seepage.

(iii) *Landscaping and grounds.* The housing project must be landscaped attractively. Lawns, plants and shrubs must be maintained and must allow air to windows, vents, and sills. Recreation areas must be maintained in a safe and clean manner and trash collection areas must be adequately sized, screened, and maintained.

(iv) *Drives, parking services and walks.* The housing project must have drives, parking lots, and walks that are free of holes and deterioration. Walks

with changes in height between slabs of approximately 1/2 inch or greater will be considered unacceptable.

(v) *Exterior signage.* All signs at the housing project, including those related to the housing project name, buildings, parking spaces, unit numbers and other informational directions must be visible and well-kept. Sign requirements must conform to § 3560.104(d).

(vi) *Fences and retaining walls.* The housing project must have fence lines that are free of trash, weeds, vines, and other vegetation. Fences must be free of holes and damaged or loose sections. The bases of all retaining walls must be erosion free and drainage weep holes must be cleaned out to prevent excessive pressure behind the retaining wall.

(vii) *Debris and graffiti.* The housing project, including common areas, must be free of trash, litter, and debris. Public walkways, walls of buildings and common areas must be free of graffiti.

(viii) *Lighting.* The housing project must have functional exterior lighting and functional interior lighting in common areas which permits safe access and security.

(ix) *Foundation.* The housing project must have a foundation that is free of evidence of structural failure, such as uneven settlement indicated by horizontal cracks or severe bowing of the foundation wall. Structural members must not have evidence of rot or insect or rodent infestation.

(x) *Exterior walls and siding.* The housing project must have walls that are free from deterioration which allows elements to infiltrate the structure, eaves, gables, and window trim that are free from deterioration, exterior wall coverings that are intact, securely attached, and in good condition. Brick veneers must be free of missing mortar or bricks.

(xi) *Roofs, flashing, and gutters.* The housing project must have gutters and downspouts, where appropriate for climatic conditions, that are securely attached, clean, and finished or painted properly with splash blocks or extenders that direct water flow away from the building. The housing project must have a roof that is free of leaks, defective covering, curled or missing shingles and which is not sagging or buckling. Fascia and soffits must be intact.

(xii) *Windows, doors, and exterior structures.* The housing project must have screens that are free of tears, breaks and rips and windows that are unbroken. Window thermopane seals must be unbroken and caulking on the exterior of windows and doors must be continuous and free of cracks. Doors

must be weather tight, free of holes, and provide security with functional locks. Porches, balconies, and exterior stairs must be free of broken, missing, or rotting components.

(xiii) *Common area accessibility.* The housing project must have accessible, designated handicapped parking spaces with handicapped space signs properly posted. Common areas must be accessible through walks, ramps, porches, and thresholds. The laundry room must have accessible appliances and mailboxes must be at an accessible level. Elevators or mechanical lifts must be functional and kept in good repair.

(xiv) *Common area signage.* The following must be posted in a conspicuous place in a common area: "Justice for All" poster, HUD equal housing opportunity poster including the Spanish version if there are Hispanic Limited English Proficiency tenants or applicants, current affirmative fair housing marketing plan, the tenant grievance and appeal procedure, housing project occupancy rules, office hours and phone number, and emergency hours and phone number.

(xv) *Flooring.* If a housing project has carpeting, the carpet must be clean, without excessive wear, and seams that are secure and stretched properly. If the housing project has resilient flooring, the flooring must be clean, unstained, free of tears and breaks, and seams that are secure.

(xvi) *Walls, floors, and ceilings.* The housing project must have walls, floors, and ceilings that are free of holes, evidence of current water leaks, and free of material that appears in danger of falling. The housing project must have wallboard joints that are secure and free of cracks.

(xvii) *Doors and windows.* The housing project must have doors that are free of holes, secure, unbroken and easily operable hardware, deadbolt locks which are in place and secure, and, if doors are metal, free of rust. The housing project must have windows which are easily operated, free of bent blinds or torn curtains, and window interiors must be free of evidence of moisture damage.

(xviii) *Electrical, air conditioning and heating.* The housing project must have heating and cooling units that are free of bare wires and which are functioning properly, including thermostats. The housing project must not have uncovered outlets or other evident safety hazards, switches which work improperly, or light fixtures which are broken and inoperable.

(xix) *Water heaters.* The housing project must have water heaters which

are operating properly, free of leaks, supply adequate hot water, and are fitted with temperature and pressure relief valves.

(xx) *Smoke alarms.* The housing project must have smoke alarms which are properly located according to local code and which operate properly.

(xxi) *Emergency call system.* If a housing project has an emergency call system, the switches must be located in the bathroom and bedroom, furnished with a pull cord, with the down position set to "ON", and must operate properly.

(xxii) *Insect or vermin infestation.* The housing project must have all units free of visible signs of insects or rodents and must be free of signs of insect or rodent damage.

(xxiii) *Range and range hood.* The housing project must have range units in which all elements are operable, electrical connections are secure and insulated, doors and drawers which are secure, control knobs and handles which are in place and secure, and housing which is sound and the finish is free of chips, damage, or signs of rust. The range hood fan and light must be operable.

(xxiv) *Refrigerator.* The housing project must have refrigerators in which the cooler and freezer are operating properly, the shelves and door containers are secure and free of rust, door gaskets are in good condition and functioning properly, and the housing is sound and the finish is free of chips, damage, or signs of rust.

(xxv) *Sinks.* The housing project must have sinks in which the fittings work properly and are free of leaks, plumbing connections under the cabinet which are free of leaks, the finish is free of chips, damage, or signs of rust, the strainer is in good condition and in place, and which are secured to a wall, counter, or vanity top.

(xxvi) *Cabinets.* The housing project must have cabinets and vanities which are secure to walls or floor and have faces, doors, and drawer fronts that are in good condition and free of breaks and peeling. Shelving must be in place, fastened securely, and free of warps. The housing project must have counter tops which are secure and free of burn marks or chips, bottoms under sinks which are free of evidence of warping, breaks, or being water soaked. Kitchen counter, vanity tops, and back splashes must be properly caulked.

(xxvii) *Water closets.* The housing project must have the base of the water closets at the floor properly caulked. The tanks must be free of cracks or leaks and have a lid which fits and is in good condition. The seats must be secure and

in good condition, and the flushing mechanisms must be in good condition and operating properly. The stools must be free of cracks and breaks and be securely fastened to the floor.

(xxviii) *Bathtub and shower stalls.* The housing project must have tubs or shower stalls which are free of cracks, breaks, and leaks, and a strainer in good condition and in place. The housing project must have walls and floors of the bathtubs which are properly caulked, tops and sides of shower stalls must be properly caulked, and the finish is free of chips, damage, or signs of rust.

(4) The Agency expects that upon discovery of a condition not in compliance with the standards listed in this section that the borrower will remedy the situation in a timeframe required by the Agency. The Borrower must provide documentation and justification for any failure to meet such timeframe. Properties with deficiencies in the process of being addressed will not be deemed to be out of compliance unless there are so many deficiencies that it would result in a declaration of substantial noncompliance and call into questions the viability of the property and the effectiveness of the borrower's maintenance program. Failure to make such corrections or repairs constitutes a non-monetary default under § 3560.452(e).

(b) *Maintenance systems.* Borrowers must establish the following maintenance systems and must describe these systems in their management plan.

(1) A system for routine maintenance, including:

(i) Regular maintenance tasks that can be prescheduled or planned; and  
(ii) Tasks performed on a regular basis to maintain compliance with the standards established in paragraph (a)(3) of this section.

(2) A system for responsive maintenance including:

(i) A process for responding to requests for maintenance from tenants;  
(ii) A process for responding to unexpected malfunctions of equipment or damages to building systems such as a furnace breakdown or a water leak; and

(iii) A "work order" process for managing and tracking responses to maintenance requests and the performance of maintenance tasks.

(3) A system for preventive maintenance including:

(i) Maintenance of mechanical systems, building exteriors, elevators, and heating and cooling systems which require specially trained personnel; and

(ii) Maintenance that supports energy-efficient operation of the housing project.

(4) A system for correcting deficiencies identified by periodic inspections, which must include:

- (i) A move-in inspection;
- (ii) A move-out inspection; and
- (iii) An annual inspection of occupied units.

(c) *Capital budgeting and planning.*

(1) Borrowers must develop a capital budget as part of their annual housing project budget required under § 3560.303. The capital budget must include anticipated expenditures on the long-term capital needs of the housing project to assure adequate maintenance and replacement of capital items.

(2) If the borrower requests an increase in the project's reserve for replacement account, the borrower must have a capital needs assessment prepared and submitted to the Agency to reflect anticipated needs of the housing project for replacement of capital equipment and systems. The cost for preparation of a capital needs assessment will be approved by the Agency as an eligible housing project expense provided the capital needs assessment is reasonable in cost and meets Agency requirements.

(3) [Reserved].

(4) As a part of the annual budget process, borrowers may request an increase in the amount to be contributed and held in the housing project reserve account to fund the needs identified in an Agency-approved capital needs assessment.

(5) At any time, borrowers may request and the Agency may approve amendments to loan or grant documents to increase the amount of funds to be contributed and held in a reserve account to cover the cost of capital improvements based on the needs identified in an Agency approved capital needs assessment. Borrowers must assure improvements are performed as specified in the capital needs assessment.

#### § 3560.104 Fair housing.

(a) *General.* Borrowers must comply with the requirements of the Fair Housing Amendments Act of 1988, and this section to meet their fair housing responsibilities.

(b) *Affirmative Fair Housing Marketing Plan.* (1) Borrowers with housing projects that have four or more rental units must prepare and maintain an Affirmative Fair Housing Marketing Plan (AFHMP) as defined in 24 CFR part 200, subpart M.

(2) Loan or grant applicants must submit an AFHMP for Agency approval prior to loan closing or grant approval. Plans must be updated by the borrower

whenever components of the plan change.

(3) Borrowers must post the approved AFHMP for public inspection at the housing project site, rental office, or at any other location where tenant applications for the project are received.

(4) When developing the plan, the following items must be considered by the borrower:

(i) *Direction of marketing activities.* The plan should be designed to attract applications for occupancy from all potentially eligible groups of people in the housing marketing area, regardless of race, color, religion, sex, age, familial status, national origin, or disability. The plan must show which efforts will be made to reach very low-income or low-income groups who would least likely be expected to apply without special outreach efforts.

(ii) *Marketing program.* The applicant or borrower should determine which methods of marketing such as radio, newspaper, TV, signs, etc., are best suited to reach those very low-income or low-income groups who are in the market area but who are least likely to apply for occupancy. Marketing must not rely on "word of mouth" advertising.

(A) *Advertising. (1) Frequency.* The borrower should advertise availability of housing units in advance of their availability to allow time to receive and process applications. Advertising by newsprint or electronic media must occur at least annually to promote project visibility, even if there is an adequate waiting list.

(2) *Posters, brochures, etc.* Any radio, TV or newspaper advertisement, pamphlets, or brochures used must identify that the complex is operated on an equal housing opportunity basis. This must be done through the use of the equal housing opportunity statement, slogan, or logo type. Copies of the proposed material must be sent when requesting approval of the plan.

(B) *Community contacts.* Community leaders and special interest groups such as community, public interest, religious organizations, and organizations for the disabled must be contacted. Owners and managers of projects with fully accessible apartments must adopt suitable means to ensure that information regarding the availability of accessible units reaches eligible persons with disabilities. In addition, owners and managers of elderly housing must ensure that information regarding eligibility reaches people who are less than 62 years old but who are eligible because they are disabled. Appropriate contacts are with physical rehabilitation centers, hospitals, workshops for the

disabled, commissions on aging, and veterans organizations.

(C) *Rental staff.* All staff persons responsible for renting the units must have had training provided on Federal, state, and local fair housing laws and regulations and in the requirements of fair housing marketing and in those actions necessary to carry out the marketing plan. Copies of instructions to the staff regarding fair housing and a summary of the training they have received must be attached to the plan when requesting approval.

(iii) *Marketing records.* Records must be maintained by the borrower reflecting efforts to fulfill the plan. These records will be reviewed by the Agency during civil rights compliance reviews. Plans will be updated as needed.

(c) *Accommodations and communication.* The borrower must take appropriate steps to ensure effective communication with applicants, tenants, and members of the public with disabilities. At a minimum, the following steps must be taken:

(1) Furnish appropriate auxiliary aids (electronic, mechanical, or personal assistance) where necessary, to afford an individual with disabilities an equal opportunity to participate in and enjoy the benefits of Agency financed housing.

(i) In determining what auxiliary aids are necessary, the borrower must give primary consideration to the requests of individuals with disabilities.

(ii) The borrower is not required to provide individually prescribed devices, readers for personal use or study, or other devices of a personal nature.

(2) Where a borrower communicates with applicants and tenants by telephone, telecommunication devices for deaf persons or equally effective communication systems must be available for use.

(3) The borrower must implement procedures to ensure that interested persons, including persons with impaired vision or hearing, can obtain information concerning the existence and location of accessible services, activities, and facilities in the housing project and community.

(4) The borrower is required to provide reasonable accommodations at the project's expense unless doing so would result in undue financial or administrative burden on the project. Examples of reasonable accommodations may include such items as the installation of grab bars, ramps, and roll-in showers. Reasonable accommodations may also include the modification of rules or policies such as permitting a disabled tenant to have a

two-bedroom unit to accommodate a resident assistant or to permit a disabled tenant to have a companion animal. The decision whether the requested accommodation is reasonable or unreasonable or whether to provide the accommodation would cause an undue financial or administrative burden lies with the borrower and would be for the borrower to defend should a complaint subsequently be filed. Borrowers may wish to consult with their legal counsel prior to denying a request. If the borrower takes the position that providing an accommodation would cause an undue financial or administrative burden, the borrower must permit the tenant to make reasonable modifications at the tenant's expense. Requests for reasonable accommodations must be handled in accordance with the management plan.

(d) *Housing sign requirements.* (1) A permanent sign identifying the housing project is required for all housing projects approved on or after September 13, 1977. Permanent signs are recommended for all housing projects approved prior to September 13, 1977. The sign must meet the following requirements:

(i) Must be located at the primary site entrance and be readable and recognizable from the roadside;

(ii) Must be located near the site manager's office when the housing project has multiple sites and portable signs must be placed where vacancies exist at other site locations of a "scattered site" housing project;

(iii) May be of any shape;

(iv) Must be not less than 16 square feet of area for housing projects with 8 or more rental units (smaller housing projects may have smaller signs);

(v) Must be made of durable material including its supports;

(vi) Must include the housing project name;

(vii) Must show rental contact information including but not limited to the office location of the housing project and a telephone number where applicant inquiries may be made;

(viii) Must show either the equal housing opportunity logotype (the house and equal sign, with the words equal housing opportunity underneath the house); the equal housing opportunity slogan "equal housing opportunity"; or the equal housing opportunity statement, "We are pledged to the letter and spirit of U.S. policy for the achievement of equal housing opportunity throughout the nation. We encourage and support an affirmative advertising and marketing program in which there are no barriers to obtaining housing because of race, color, religion,

sex, handicap, familial status, or national origin." If the logotype is used, the size of the logo must be no less than 5 percent of the total size of the project sign.

(ix) May display the Agency or Department logotype; and

(x) Must comply with state and local codes.

(2) Accessible parking spaces must be reserved for individuals with disabilities by a sign showing the international symbol of accessibility. The sign must be mounted on a post at a height that is readily visible from an occupied vehicle. In snow areas, the sign must be visible above piled snow. If there is an office, the designated parking space must be van accessible.

(3) When the continuous unobstructed ingress or egress disabled accessibility route to a primary building entrance is other than the usual or obvious route, the alternate route for disabled accessibility must be clearly marked with international accessibility symbols and directional signs to aid a disabled person's ingress or egress to the building, through an accessible entrance, and to the accessible common use and public and living areas.

#### § 3560.105 Insurance and taxes.

(a) *General.* Borrowers must purchase and maintain property insurance on all buildings included as security for an Agency loan. Also, borrowers must furnish fidelity coverage, liability insurance, and any other insurance coverage required by the Agency in accordance with this paragraph to protect the security of the asset. Failure to maintain adequate insurance coverage or pay taxes may lead to a non-monetary default under § 3560.452(c).

(b) *General insurance requirements.* All insurance policies must meet the requirements established by the loan documents and this section.

(1) At loan closing, prior to loan approval, applicants must provide documentary evidence that insurance requirements have been met. The borrower must maintain insurance in accordance with requirements of their loan or grant documents and this section until the loan is repaid or the terms of the grant expire.

(2) Insurance companies must meet the requirements of paragraph (e) of this section.

(3) Insurance coverage amount, terms, and conditions must meet the requirements of paragraph (f) of this section.

(4) The Agency must be named as loss co-payee on all property insurance policies where it holds first lien position. The Agency must be named as

an additional insured if its lien position is other than first.

(c) *Borrower failure or inability to meet insurance requirements.* The Agency will take the following actions in cases where a borrower is unwilling or unable to meet the Agency's insurance requirements:

(1) The Agency will obtain insurance for Agency financed property if the borrower fails to do so. If borrowers refuse to pay the insurance premium, the Agency will pay the insurance premium and charge the premium payment amount to the borrower's Agency account and will place the borrower in default as described in § 3560.452(c).

(2) If borrowers habitually fail to pay premiums in a timely manner, the Agency will require borrowers to escrow amounts appropriate to pay insurance premiums.

(3) If insurance that meets the Agency's specified requirements is not available (e.g. flood or hurricane insurance), the Agency may accept the insurance policy that most nearly conforms to established requirements.

(4) If the best insurance policy a borrower can obtain at the time the borrower receives the loan or grant contains a loss deductible clause greater than that allowed by paragraph (f)(8) of this section, the insurance policy and an explanation of the reasons why more adequate insurance is not available must be submitted to the Agency prior to loan or grant approval.

(d) *Credits, refunds, or rebates.*

Borrowers must credit any refund or rebate from an insurance company to the project's general operating account or reserve account.

(e) *Insurance company requirements.* All insurers, insurance agents, and brokers must meet the following requirements:

(1) Be licensed or authorized to do business in the state or jurisdiction where the housing project is located; and

(2) Be deemed reputable and financially sound as determined by the Agency.

(f) *Property insurance.* The following conditions apply to property insurance purchased for Agency-financed housing projects.

(1) At a minimum, borrowers must obtain the following types of property insurance:

(i) *Hazard insurance.* A policy which generally covers loss or damage by fire, smoke, lightning, hail, explosion, riot, civil commotion, aircraft, and vehicles. These policies may also be known as "Fire and Extended Coverage,"

“Homeowners,” “All Physical Loss,” or “Broad Form” policies.

(i) *Flood insurance.* This coverage is required for properties located in Special Flood Hazard Areas (SFHA) as defined in 44 CFR part 65, as determined by the Federal Emergency Management Agency (FEMA).

(ii) *Builder’s risk insurance.* A policy that insures dwellings under construction or rehabilitation.

(iv) *Elevators, boiler, and machinery coverage.* This coverage is required for properties that operate elevators, steam boilers, turbines, engines, or other pressure vessels.

(2) Other types of insurance that the Agency may require:

(i) Windstorm Coverage.

(ii) Earthquake Coverage.

(iii) Sinkhole Insurance or Mine Subsidence Insurance.

(3) For property insurance, the minimum coverage amount must equal the “Total Estimated Reproduction Cost of New Improvements,” as reflected in the housing project’s most recent appraisal. At a minimum, property insurance coverage must be adequate to cover the lesser of the depreciated replacement value of essential buildings or the unpaid balance of all secured debt, unless such coverage is financially unfeasible for the housing project.

(i) If the cost of the minimum level of property insurance coverage exceeds what the housing project can reasonably afford, the borrower, with Agency concurrence, must obtain the maximum amount of property insurance coverage that the housing project can afford.

(ii) If the coverage amount is less than the depreciated replacement value of all essential buildings, borrowers must obtain coverage on one or more of the most essential buildings, as determined by the Agency.

(iii) When required, the coverage amount for flood insurance must equal the outstanding loan balance or the maximum coverage allowed by FEMA’s “National Flood Insurance Program.”

(4) Except for flood insurance, property insurance is not required if the housing project:

(i) Has a depreciated replacement value of \$2,500 or less; or

(ii) Is in a condition which the Agency determines makes insurance coverage not economical.

(5) Policies for several buildings or properties located on noncontiguous sites are acceptable if the insurer provides proof that each secured building or property related to the housing project is as fully protected as if a separate policy were issued.

(6) Borrowers must notify the Agency and their insurance company agents of

any loss or damage to insured property and collect the amount of the loss.

(7) When the Agency is in the first lien position and an insurance settlement represents a satisfactory adjustment of a loss, the insurance settlement will be deposited in the housing project’s general operating account unless the settlement exceeds \$5,000. If the settlement exceeds \$5,000, the funds will be placed in the reserve account for the housing project.

(i) Insurance settlement funds which remain after all repairs, replacements, and other authorized disbursements have been made retain their status as housing project funds.

(ii) If the indebtedness secured by the insured property has been paid in full or the insurance settlement is in payment for loss of property on which the Agency has no claim; a loss draft which includes the Agency as co-payee may be endorsed by the Agency without recourse and delivered to the borrower.

(8) When the Agency is not in the first lien position and the insurance settlement represents satisfactory adjustment of the loss, the Agency will release the settlement funds to the primary mortgagee upon agreement of all parties to the provisions contained in agreements between the Agency and the primary lienholder.

(9) Allowable deductible amounts are as follows:

(i) *Hazard/Property Insurance.* (A) \$1,000 on any housing project with an insurable value under \$200,000; or

(B) One-half of one percent (0.0050) of the insurable value, up to \$10,000 on housing projects with insurance values over \$200,000.

(ii) *Flood Insurance.* The Agency allows a maximum deductible of \$5,000 per building.

(iii) *Windstorm Coverage.* When windstorm coverage is excluded from the “All Risk” policy, the deductible must not exceed five percent of the total insured value.

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

(v) *Sinkhole Insurance or Mine Subsidence Insurance.* The deductible for sinkhole insurance or mine subsidence insurance should be similar to what would be required for earthquake insurance.

(10) Deductible amounts (excluding flood, windstorm, earthquake and sinkhole insurance or mine subsidence insurance) must be accounted for in the replacement reserve account. Borrowers who wish to increase the deductible

amount must deposit an additional amount to the reserve account equal to the difference between the Agency’s maximum deductible and the requested new deductible. The Borrower will be required to maintain this additional amount so long as the higher deductible is in force.

(g) *Liability insurance.* The borrower must carry comprehensive general liability insurance with coverage amounts that meet or exceed Agency requirements. This coverage must insure all common areas, commercial space, and public ways in the security premises. Coverage may also include borrower exposure to certain risks such as errors and omissions, environmental damages, or protection against discrimination claims. The insurer’s limit of liability per occurrence for personal injury, bodily injury, or property damage under the terms of coverage must be at least \$1 million.

(h) *Fidelity coverage.* Borrowers must provide fidelity coverage on any personnel entrusted with the receipt, custody, and disbursement of any housing monies, securities, or readily salable property other than money or securities. Borrowers must have fidelity coverage in force as soon as there are assets within the organization and it must be obtained before any loan funds or interim financing funds are made available to the borrower. In addition, the following conditions apply to fidelity insurance:

(1) Fidelity insurance coverage must be documented on a bond form acceptable to the Agency.

(2) Fidelity coverage policies must declare in the insuring agreements that the insurance company will provide protection to the insured against the loss of money, securities, and property other than money and securities, through any criminal or dishonest act or acts committed by any employee, whether acting alone or in collusion with others, not to exceed the amount of indemnity stated in the declaration of coverage.

(i) The fidelity insurance policy, at a minimum, must include an insuring agreement that covers employee dishonesty.

(ii) Fidelity coverage amounts and deductible:

Fidelity coverage	Deductible level
Under \$50,000 .....	\$1,000
In the area of \$100,000 .....	2,500
In the area of \$250,000 .....	5,000
In the area of \$500,000 .....	10,000
In the area of \$1,000,000 .....	15,000

(3) Blanket crime insurance coverage or fidelity bonds are acceptable types of fidelity coverage.

(4) At a minimum, borrowers must provide an endorsement, listing all of the borrower's Agency financed properties and their locations covered under the policy or bond as evidence of required fidelity insurance. The policy or bond may also include properties or operations other than Agency financed properties on separate endorsement listings.

(5) Individual or organizational borrowers must have fidelity coverage when they have employees with access to the MFH complex assets. Borrowers who use a management agent with exclusive access to housing assets must require the agent to have fidelity coverage on all principals and employees with access to the housing assets. If active management reverts to the borrower, the borrower must obtain fidelity coverage, as a first course of business.

(6) Fidelity coverage is not required under the following circumstances:

(i) The borrower is an individual or a general partnership and the individual or general partner will be responsible for the financial activities of the housing project.

(ii) In the case of a land trust where the beneficiary is responsible for management, the beneficiary will be treated as an individual.

(iii) A limited partnership (or its general partners) unless one or more of its general partners perform financial acts within the scope of the usual duties of an "employee."

(7) The premium for fidelity coverage of employees and general partners at a housing project is an eligible operating account expense.

(i) The premium of a management agent's fidelity coverage for the agent's principals and employees will be the management agent's business expense (*i.e.*, it is included within the management fee).

(ii) When a housing project employee is covered under the "umbrella" of the management agent's fidelity coverage, the premium may be prorated among the housing projects covered.

(8) Borrowers must review fidelity coverage annually and adjust it as necessary to comply with the requirements of this section.

(i) **Taxes.** The borrower is responsible for paying all taxes and assessments on a housing project before they become delinquent.

(1) An exception to the above may be made if the borrower has formally contested the amount of the property assessment and escrowed the amount of

taxes in question in a manner approved by the Agency.

(2) Failure to pay taxes and assessments when due will be considered a default. If a borrower fails to pay outstanding taxes and assessments, the Agency will pay the outstanding balance and charge the tax or assessment amount, assessed penalties, and any additional incurred costs to the borrower's Agency account.

(3) The Agency will require borrowers who have demonstrated an inability to pay taxes in a timely manner to escrow amounts sufficient to pay taxes.

#### **§§ 3560.106–3560.149 [Reserved].**

#### **§ 3560.150 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

#### **Subpart D—Multi-Family Housing Occupancy**

##### **§ 3560.151 General.**

(a) **Applicability.** This subpart contains borrower and tenant requirements and Agency responsibilities related to occupancy of Agency-financed multi-family housing (MFH) projects. Occupancy eligibility requirements apply to the following:

(1) Family housing projects, including farm labor housing;

(2) Elderly housing projects; and

(3) Congregate housing or group homes for persons with special needs.

(b) **Civil rights requirements.** All occupancy policies must meet applicable civil rights requirements, as stated in § 3560.2.

##### **§ 3560.152 Tenant eligibility.**

(a) **General requirements.** Except as specified in paragraph (b) of this section, a tenant eligible for occupancy in Agency-financed housing must either:

(1) Be a United States citizen or qualified alien, and

(2) Qualify as a very low-, low-, or moderate-income household; or

(3) Be eligible under the requirements established to qualify for housing benefits provided by sources other than the Agency, such as U.S. Department of Housing and Urban Development (HUD) Section 8 assistance or Low Income Housing Tax Credit (LIHTC), when a tenant receives such housing benefits.

(b) **Exception.** Households with incomes above the moderate-income level may occupy housing projects with an Agency loan approved prior to 1968 with a loan agreement that does not restrict occupancy by income.

(c) **Requirements for elderly housing, elderly units in mixed housing, congregate housing, and group homes.** In addition to the requirements of paragraph (a) of this section, the following occupancy requirements apply to elderly housing, elderly units in mixed housing, and congregate housing or group homes:

(1) For elderly housing, elderly units in mixed housing, and congregate housing the following provisions apply:

(i) Households must meet the definition of an elderly household in § 3560.11 to be eligible for occupancy in elderly or congregate housing.

(ii) If non-elderly persons are members of a household where the tenant or co-tenant is an elderly person, the non-elderly persons are eligible for occupancy in the tenant's or co-tenant's rental unit.

(iii) Applicants who will agree to participate in the services provided by a congregate housing project may be given occupancy priority.

(2) For group homes, the following provisions apply:

(i) Occupancy may be limited to a specific group of tenants, such as elderly persons or persons with developmental disabilities, or mental impairments, if such an occupancy limitation is contained in the borrower's management plan.

(ii) Tenants must be able to demonstrate a need for the special services provided by the group home.

(iii) Tenants cannot be required to participate in an ongoing training or rehabilitation program.

(iv) Tenants must be selected from the market area prior to considering applicants from other areas.

(d) **Ineligible tenant waiver.** The Agency may authorize the borrower in writing, upon receiving the borrower's written request with the necessary documentation, to rent vacant units to ineligible persons for temporary periods to protect the financial interest of the Government. Likewise, this provision may extend to a cooperative. This authority will be for the entire project for periods not to exceed one year.

Within the period of the lease, the tenant may not be required to move to allow an eligible applicant to obtain occupancy, should one become available. The Agency must make the following determinations:

(1) There are no eligible persons on a waiting list.

(2) The borrower provided documentation that a diligent but unsuccessful effort to rent any vacant units to an eligible tenant household has been made. Such documentation may consist of advertisements in appropriate publications, posting notices in several public places, including places where persons seeking rental housing would likely make contacts, holding open houses, making appropriate contacts with public housing agencies and organizations, Chambers of Commerce, and real estate agencies.

(3) The borrower agrees to continue with aggressive efforts to locate eligible tenants and retain documentation of all marketing.

(4) The borrower is temporarily unable to achieve or maintain a level of occupancy sufficient to prevent financial default and foreclosure. The Agency's approval of the waiver would then be for a limited duration.

(5) The lease agreement will not be more than 12 months and at its expiration will convert to a month-to-month lease. The monthly lease will require that the unit be vacated upon 30 days notice when an eligible applicant is available.

(6) Tenants residing in Rural Rental Housing (RRH) units who are ineligible because their adjusted annual income exceeds the maximum for the RRH project will be charged the Rural Housing Service (RHS) approved note rent for the size of unit occupied in a Plan II RRH project. In projects operated under Plan I, ineligible tenants will be charged a rental surcharge of 25 percent of the approved note rent.

(e) *Tenant certification and verification.* Tenants and borrowers must execute an Agency-approved tenant certification form establishing the tenant's eligibility prior to occupancy. In addition, tenant households must be recertified and must execute a tenant certification form at least annually or whenever a change in household income of \$100 or more per month occurs. Borrowers must recertify for changes of \$50 per month, if the tenant requests that such a change be made.

(1) *Tenant requirements.* (i) Tenants must provide borrowers with the necessary income and other household information required by the Agency to determine eligibility.

(ii) Tenants must authorize borrowers to verify information provided to establish their eligibility or determination of tenant contribution.

(iii) Tenants must report all changes in household status that may affect their eligibility to borrowers.

(iv) Tenants who fail to comply with tenant certification and recertification requirements will be considered ineligible for occupancy and will be subject to unauthorized assistance claims, if applicable, as specified in subpart O of this part.

(2) *Borrower requirements.* (i) Borrowers must verify household income and other information necessary to establish tenant eligibility for the requested rental unit type, in a format approved by the Agency, prior to a tenant's initial occupancy and prior to annual or other recertifications.

(ii) Borrowers must review all reported changes in household status and assess the impact of these changes on the tenant's eligibility or tenant contribution.

(iii) Borrowers must submit initial or updated tenant certification forms to the Agency within 10 days of the effective date of an initial certification or any changes in a tenant's status. The effective date of an initial or updated tenant certification form will always be a first day of the month.

(iv) Since tenant certifications are used to document interest credit and rental assistance eligibility and are a basic responsibility of the borrower under the loan documents, borrowers who fail to submit annual or updated tenant certification forms within the time period specified in paragraph (e)(2)(iii) of this section will be charged overage, as specified in § 3560.203(c). Unauthorized assistance, if any, will be handled in accordance with subpart O of this part.

(v) Borrowers must submit tenant certification forms to the Agency using a format approved by the Agency.

(vi) Borrowers must retain executed tenant certification forms and any supporting documentation in the tenant file for at least 3 years or until the next Agency monitoring visit or compliance review, whichever is longer.

(3) The Agency maintains the right to independently verify tenant eligibility information.

**§ 3560.153 Calculation of household income and assets.**

(a) Annual income will be calculated in accordance with 24 CFR 5.609.

(b) Adjusted income will be calculated in accordance with 24 CFR 5.611.

**§ 3560.154 Tenant selection.**

(a) *Application for occupancy.* Borrowers must use tenant application forms that collect sufficient information to properly determine household eligibility and to enable the Agency to monitor compliance with the Fair Housing Act, section 504 of the Rehabilitation Act of 1973, and title VI of the Civil Rights Act of 1964 during compliance reviews. At a minimum, borrowers must use application forms that collect the following information:

(1) Name of the applicant and present address;

(2) Number of household members and their birthdates;

(3) Annual income information calculated in accordance with § 3560.153(a);

(4) Adjustments to income calculated in accordance with § 3560.153(b);

(5) Net assets calculated in accordance with § 3560.153(c);

(6) Indication of a need for a unit accessible to individuals with disabilities and any disability adjustments to income;

(7) Certification by the applicant that the unit will serve as the household's primary residence, and a certification that the applicant is a U.S. citizen or a qualified alien as defined in § 3560.11;

(8) Signature of the applicant and date;

(9) Race, ethnicity, and sex designation. The following disclosure notice shall be used:

"The information regarding race, ethnicity, and sex designation solicited on this application is requested in order to assure the Federal Government, acting through the Rural Housing Service, that the Federal laws prohibiting discrimination against tenant applications on the basis of race, color, national origin, religion, sex, familial status, age, and disability are complied with. You are not required to furnish this information, but are encouraged to do so. This information will not be used in evaluating your application or to discriminate against you in any way. However, if you choose not to furnish it, the owner is required to note the race, ethnicity, and sex of individual applicants on the basis of visual observation or surname," and

(10) Social security number.

(b) *Additional information.* Applicants are to be provided a list of any additional information that must be submitted with the application for the application to be considered complete (an application will be considered complete without verification of the applicant information). The list of information will be restricted to the same items for all Agency-assisted properties of a particular type, such as a family or elderly complex.

(c) *Application submission.* Borrowers must establish when applications may be submitted. Information on the place and times for tenant application submission must be documented in the housing project's management plan and Affirmative Fair Housing Marketing Plan.

(d) *Selection of eligible applicants.* (1) Applicants may be determined ineligible for occupancy based on selection criteria other than Agency requirements only if such criteria are contained in the borrower's management plan. Borrower established selection criteria may not contain arbitrary or discriminatory rejection criteria, but may consider an applicant's past rental and credit history and relations with other tenants.

(2) Borrowers with projects receiving low-income housing tax credits (LIHTCs), may leave a housing unit vacant if they are required to rent the available unit to a LIHTC-eligible applicant, and none of the applicants on the waiting list meet the applicable LIHTC eligibility requirements.

(e) *Recordkeeping.* Borrowers must retain all tenant application forms for at least 3 years. The Agency may require borrowers to submit application information for Agency review.

(f) *Waiting lists.* (1) When an applicant has submitted an application form the borrower must place the applicant on the waiting list. All applications, whether complete, eligible, or ineligible, will be placed on the list. The waiting list will document the final disposition of all applications (rejected, withdrawn, or placed in a unit).

(2) The date and time a complete application was submitted will be recorded on the waiting list and will establish priority for selection from the list. If an applicant submits an incomplete application (see paragraph (a) of this section), they must be notified in writing within 10 days of the items that are needed for the application to be considered complete and that priority will not be established until the additional items are received.

(3) The race and the ethnicity of each applicant shall be recorded on the waiting list. This information shall be collected for statistical purposes only and must not be used when making eligibility determinations or in any other discriminatory manner. The information shall be recorded using the race and ethnicity codes that are utilized on the Agency tenant certification form available in the servicing office.

(4) Within 10 days of receipt of a complete application, the Borrower

must notify the applicant in writing that he has been selected for immediate occupancy, placed on a waiting list, or rejected.

(5) Selections from the completed applications on the waiting list shall be made in the following priority order:

- (i) Very low-income applicants;
- (ii) Low-income applicants; and
- (iii) Moderate-income applicants.

(g) *Priorities and preferences for admission.* (1) Eligible applicants that meet the following conditions must be given priority for occupancy over all other tenants regardless of income. Such applicants, however, will be ranked among themselves by income level, giving priority first to very low-income households, then to low-income households, and finally to moderate-income households.

(i) Persons who require the special design features of a unit accessible to individuals with disabilities will have priority only for units with these features.

(ii) In congregate housing facilities, persons who agree to use the services provided by the facility will have priority over other applicants.

(2) Eligible applicants that meet any of the following conditions must be given priority over other applicants in their same income category.

(i) The applicant has a Letter of Priority Entitlement (LOPE) issued in accordance with § 3560.660(c).

(ii) The applicant was displaced from Agency-financed housing but was not issued a LOPE.

(iii) The applicant was displaced in a Federally declared disaster area.

(3) Borrowers receiving Section 8 project-based assistance may establish preferences in accordance with U.S. Department of Housing and Urban Development (HUD) regulations. The use of such preferences must be documented in the project's management plan.

(h) *Notices of ineligibility or rejection.*

Borrowers must provide written notification to applicants who are determined to be ineligible or who are rejected for occupancy. Notices of ineligibility or rejection must give specific reasons for the ineligibility determination or rejection and, in accordance with § 3560.160, the notice must advise the applicant of "the right to respond to the notice within ten calendar days after receipt" and of "the right to a hearing in accordance with § 3560.160 which is available upon request." When an applicant is rejected based on the information from a credit bureau report, the source of the credit bureau report must be revealed to the

applicant in accordance with the Fair Credit Reporting Act.

(i) *Purging waiting list.* Procedures used by borrowers to purge waiting list must be documented in the project's management plan and must be based on the length of the waiting list or the extent of time an applicant will be expected to wait for housing. At a minimum, borrowers must document removal of any names from the waiting list with the time and date of the removal. If an electronic waiting list is used, borrowers must periodically print out electronic waiting lists or preserve backup copies showing how the waiting list appeared before and after the removal of each name.

(j) *Criminal activity.* Borrowers may deny admission for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.854, 5.855, 5.856, and 5.857.

#### **§ 3560.155 Assignment of rental units and occupancy policies.**

(a) *General.* Available rental units are assigned in accordance with the requirements of this section and the priorities and preferences outlined in § 3560.154.

(b) *Rental units accessible to individuals with disabilities.* If a rental unit accessible to individuals with disabilities is available and there are no applicants that require the features of the unit, borrowers may rent the unit to a non-disabled tenant subject to the inclusion of a lease provision that requires the tenant to vacate the unit within 30 days of notification from management that an eligible individual with disabilities requires the unit and provided the accessible unit has been marketed as an accessible unit, outreach has been made to organizations representing the disabled, and marketing of the unit as an accessible unit continues after it has been rented to a tenant who is not in need of the special design features.

(c) *Transfer of existing tenants within a housing project.* When a rental unit becomes available for occupancy and an eligible tenant in the housing project is either over housed or under housed as provided for in paragraph (e) of this section, the borrower must use the available unit for the over housed or under housed tenant, if suitable, prior to selecting an eligible applicant from the waiting list.

(d) *Applicant placement.* When a specific rental unit type becomes available for occupancy, borrowers must select eligible applicants suitable for the available unit according to the priorities established in § 3560.154.

(e) *Occupancy policies.* Borrowers must establish occupancy policies for each housing project. Households living in a rental unit with more bedrooms than persons in the household will be considered over housed and must be relocated in accordance with paragraph (c) of this section. Households under housed as defined by the project's occupancy standards must be relocated in accordance with paragraph (c) of this section. Borrowers with no one-bedroom units in a housing project may make an exception to this requirement in their occupancy policies. In addition, a borrower's occupancy policies must establish:

(1) Reasonable standards for determining when a tenant household is considered under housed. The standards will describe the maximum number of persons that may occupy units of a given size based on occupancy guidelines provided by the Agency or another governmental source;

(2) The order in which eligible applicants and existing tenants will be housed or re-housed; and

(3) How fair housing requirements will be met, including how reasonable accommodations will be made for applicants and tenants with disabilities.

(f) *Agency concurrence.* The Agency must concur with a borrower's occupancy rules prior to initial occupancy of the housing project. All modifications to occupancy rules must be posted for tenant comment in accordance with § 3560.160 and receive Agency concurrence prior to implementation.

#### § 3560.156 Lease requirements.

(a) *Agency approval.* Borrowers must use a lease approved by the Agency. The lease must be consistent with Agency requirements and the requirements of all programs participating in the housing project. Prior to submitting the lease to the Agency for approval, borrowers must have their attorney certify that the lease complies with state and local laws, Agency requirements, and the requirements of all programs participating in the housing project. If there are conflicting requirements the borrower shall notify the Agency of the conflict and request guidance. Borrowers must execute their Agency approved lease with each tenant household prior to tenant occupancy of a rental unit.

(b) *Lease requirements.* (1) All leases must be in writing.

(2) Initial leases must be for a 1-year period.

(3) If the tenant is not subject to occupancy termination according to § 3560.158 and § 3560.159, a renewal

lease or lease extension must be for a 1-year period.

(4) In areas with a concentration of non-English speaking populations, leases (including the occupancy rules) must be available in both English and the non-English language.

(5) Leases must give the address of the management agent to which tenants may direct complaints.

(6) Leases must include a statement of the terms and conditions for modifying the lease.

(c) *Required items and provisions.* (1) Leases for tenants who hold a Letter of Priority Entitlement (LOPE) issued according to § 3560.655(d) and are temporarily occupying a unit for which they are not eligible must include a clause establishing the tenant's responsibility to move when a suitable unit becomes available in the housing project.

(2) Leases must contain a clause permitting escalation in the tenant contribution when there is an Agency-approved change in basic or note rate rents prior to the expiration of the lease. The escalation clause also must specify that the tenant contribution may be changed prior to expiration of the lease if the change is due to changes in tenant status, as documented on the tenant certification form, or the tenant's failure to properly recertify.

(3) Leases must specify that no change in the tenant contribution will occur due to monetary or non-monetary default or when rental assistance or interest credit, is suspended, canceled, or terminated due to the borrower's fault. For information on tenant contributions when a borrower prepays the Agency loan, refer to subpart N of this part.

(4) Leases must contain a requirement that tenants make restitution when unauthorized assistance is received due to applicant or tenant fraud or misrepresentation and a statement advising tenants that submission of false information could result in legal action.

(5) Leases must include a statement that the housing project is financed by the Agency and that the Agency has the right to further verify information provided by the applicant.

(6) Leases must state that the housing project is subject to:

(i) Title VI of the Civil Rights Act of 1964;

(ii) Title VIII of the Fair Housing Act;

(iii) Section 504 of the Rehabilitation Act of 1973; and

(iv) The Age Discrimination Act of 1975.

(7) Leases must establish the tenant's responsibility according to the housing project's occupancy rules to move to the

next available appropriately sized rental unit if the household becomes over housed or under housed in the unit they occupy.

(8) Leases must include provisions that establish when a guest will be considered a member of the household and be required to be added to the tenant certification.

(9) Leases must include a provision stating that tenancy continues until the tenant's possessions are removed from the housing either voluntarily or by legal means, subject to state and local law.

(10) Leases must include a requirement that tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in § 3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, or whichever is greater, unless the conditions cited in § 3560.158(c) exist;

(11) Leases for rental units receiving rental assistance must include clauses that specify that the tenant's monthly tenant contribution and a description of the circumstances under which the tenant's contribution may change.

(12) Leases must include a requirement that tenants notify borrowers when changes occur in their income or assets, their qualifications for adjustments to income, their citizenship status, or the number of persons living in the unit.

(13) A requirement that tenants agree to fulfill the tenant income verification and certification requirements established under § 3560.152.

(14) Leases for tenants living in Plan II interest credit rental units must include provisions establishing the net monthly tenant contribution.

(15) Leases, including renewals, must include the following language:

"It is understood that the use, or possession, manufacture, sale, or distribution of an illegal controlled substance (as defined by local, State, or federal law) while in or on any part of this apartment complex or cooperative is an illegal act. It is further understood that such action is a material lease violation. Such violations (hereafter called a "drug violation") may be evidenced upon the admission to or conviction of the use, possession, manufacture, sale, or distribution of a controlled substance (as defined by local, state, or Federal law) in any local, state, or Federal court.

The landlord may require any lessee or other adult member of the tenant household occupying the unit (or other adult or non-adult person outside the tenant household who is using the unit) who commits a drug violation to vacate the leased unit

permanently, within timeframes set by the landlord, and not thereafter to enter upon the landlord's premises or the lessee's unit without the landlord's prior consent as a condition for continued occupancy by the remaining members of the tenant's household. The landlord may deny consent for entry unless the person agrees to not commit a drug violation in the future and is either actively participating in a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program.

The landlord may require any lessee to show evidence that any non-adult member of the tenant household occupying the unit, who committed a drug violation, agrees not to commit a drug violation in the future, and to show evidence that the person is either actively seeking or receiving assistance through a counseling or recovery program, complying with court orders related to a drug violation, or has successfully completed a counseling or recovery program within timeframes specified by the landlord as a condition for continued occupancy in the unit. Should a further drug violation be committed by any non-adult person occupying the unit the landlord may require the person to be severed from tenancy as a condition for continued occupancy by the lessee.

If a person vacating the unit, as a result of the above policies, is one of the lessees, the person shall be severed from the tenancy and the lease shall continue among any other remaining lessees and the landlord. The landlord may also, at the option of the landlord, permit another adult member of the household to be a lessee.

Should any of the above provisions governing a drug violation be found to violate any of the laws of the land the remaining enforceable provisions shall remain in effect. The provisions set out above do not supplant any rights of tenants afforded by law."

(16) Leases for rental units accessible to individuals with disabilities occupied by those not needing the accessibility features must establish the tenant's responsibility to move to another unit when an appropriate unit becomes available or when the unit is needed by an eligible individual with disabilities. Additionally, the lease clause must require the borrower to provide tenants written notification of the date by which they must move to another unit in the project.

(17) If loan prepayment occurs and the housing project is subject to restrictive use provisions, leases and renewals must be amended to include a clause specifying the tenant protections required under subpart N of this part.

(18) All leases must contain the following information and provisions:

- (i) The name of the tenant, any co-tenants, and all members of the household residing in the rental unit;
- (ii) The identification of the rental unit;

(iii) The amount and due date of monthly tenant contributions, any late payment penalties, and security deposit amounts;

(iv) The utilities, services, and equipment to be provided for the tenant;

(v) The tenant's utility payment responsibility;

(vi) The certification process for determining tenant occupancy eligibility and contribution;

(vii) The limitations of the tenant's right to use or occupancy of the dwelling;

(viii) The tenant's responsibilities regarding maintenance and consequences if the tenant fails to fulfill these responsibilities;

(ix) The agreement of the borrower to accept the tenant contribution toward rent charges prior to payment of other charges that the tenant owes and a statement that borrowers may seek legal remedy for collecting other charges accrued by the tenant;

(x) The maintenance responsibilities of the borrower in buildings and common areas, according to state and local codes, Agency regulations, and Federal fair housing requirements;

(xi) The responsibility of the borrowers at move-in and move-out to provide the tenant with a written statement of rental unit's condition and provisions for tenant participation in inspection;

(xii) The provision for periodic inspections by the borrower and other circumstances under which the borrower may enter the premises while a tenant is renting;

(xiii) The tenant's responsibility to notify the borrower of an extended absence;

(xiv) A provision that tenants may not assign the lease or sublet the property;

(xv) A provision regarding transfer of the lease if the housing project is sold to an Agency-approved buyer;

(xvi) The procedures that must be followed by the borrower and the tenant in giving notices required under terms of the lease including lease violation notices;

(xvii) The good-cause circumstances under which the borrower may terminate the lease and the length of notice required;

(xviii) The disposition of the lease if the housing project becomes uninhabitable due to fire or other disaster, including rights of the borrower to repair building or terminate the lease;

(xix) The procedures for resolution of tenant grievances consistent with the requirements of § 3560.160;

(xx) The terms under which a tenant may, for good cause, terminate their

lease, with 30 days notice, prior to lease expiration; and

(xxi) The signature and date clause indicating that the lease has been executed by the borrower and the tenant.

(d) *Prohibited provisions.* Borrowers are prohibited from including any of the following clauses in the lease:

(1) Clauses prohibiting families with children under 18;

(2) Clauses requiring prior consent by tenant to any lawsuit that borrowers may bring against the tenant in connection with the lease;

(3) Clauses authorizing borrowers to hold any of a tenant's property until the tenant fulfills an obligation;

(4) Clauses in which tenants agree not to hold borrowers liable for anything they may do or fail to do;

(5) Clauses in which tenants agree that borrowers may institute suit without any notice to the tenant that the suit has been filed;

(6) Clauses in which tenants agree that borrowers may evict the tenant or sell their possessions whenever borrowers determine that a breach or default has occurred;

(7) Clauses authorizing the borrower's attorneys to appear in court on behalf of the tenant, and to waive the tenant's right to a trial by jury;

(8) Clauses authorizing the borrower's attorneys to waive the tenant's right to appeal or to file suit; and

(9) Clauses requiring the tenant to agree to pay legal fees and court costs whenever the borrower takes action against the tenant, even if the court finds in favor of the tenant.

(e) *Housing projects and units receiving HUD assistance.* (1) In housing projects receiving Section 8 project-based assistance, borrowers may use the HUD model lease. The provisions of the HUD model lease will prevail, unless they conflict with Agency lease requirements in accordance with this section. If there is conflict between HUD requirements and Agency requirements, the provision that will be enforced will be the one that is most favorable to the tenant.

(2) For units occupied by Section 8 certificate and voucher holders, borrowers may use:

- (i) A standard HUD-approved lease;
- (ii) A HUD-approved lease that includes a number of modifications from the standard HUD-approved lease; or

(iii) An Agency-approved lease may be used if acceptable by HUD or the local housing authority.

(f) *State and local requirements.* Borrowers must use a lease that is consistent with state and local requirements.

(1) If any lease provision is in violation of state or local law, the lease may be modified to the extent needed to comply with the law, but any changes must be consistent with the provisions established in paragraph (c) of this section.

(2) Leases must include a procedure for handling tenant's abandoned property, as provided by state or local law.

**§ 3560.157 Occupancy rules.**

(a) *General.* The purpose of a borrower's occupancy rules is to outline the basis for the tenant and management relationship. Prior to Agency approval of occupancy rules, borrowers must provide written certification from their attorney that the housing project's occupancy rules are consistent with applicable Federal, state, and local laws, as well as Agency requirements, and the requirements of all programs participating in the housing project. Borrowers must obtain Agency approval of the occupancy rules prior to initial occupancy and obtain Agency approval prior to the implementation date of any subsequent modifications to the rules.

(b) *Requirements.* The occupancy rules must be in writing and posted for easy tenant access. A copy of these rules must be attached to the tenant's lease upon initial occupancy. At a minimum, the occupancy rules must address:

- (1) The tenant's rights and responsibilities under the lease or occupancy agreement;
- (2) The rent payment or occupancy charge policies;
- (3) The policies regarding periodic inspection of units;
- (4) The system for responding to tenant complaints;
- (5) The maintenance request and work order procedures;
- (6) The housing services and facilities available to tenants or members;
- (7) The office locations, hours, and emergency telephone numbers;
- (8) The restrictions on storage and prohibitions on non-functional vehicles in the housing project area;
- (9) Other requirements related to a subsidy provided to a tenant from non-Agency sources;
- (10) When a guest becomes a member of the tenant household; and
- (11) The procedures tenants must follow to request reasonable accommodations.

(c) *Modification of occupancy rules.* The Agency must concur with any modification to the occupancy rules prior to implementation. Proper notice must be given to each tenant at least 30 days in advance of implementation of such rules in accordance with § 3560.160.

(d) *Federal, state and local requirements.* The occupancy rules must be consistent with Federal, state, and local law.

(e) *Pets/Assistance Animals.* All housing projects should establish reasonable written pet rules. No rules may be promulgated that would prevent occupancy by a household member who requires a service or assistance animal. In elderly housing, borrowers must not prohibit tenants from keeping domestic animals in their rental units as pets.

(f) *Tenant organizations.* Borrowers must not infringe on the rights of tenants to organize an association of tenants. Borrowers (or a designated management representative) should be available and willing to work with a tenant organization.

(g) *Community rooms.* Borrowers may not place unreasonable restrictions on tenants that desire to use a community room.

**§ 3560.158 Changes in tenant eligibility.**

(a) *General requirements.* Tenants must continue to meet the requirements of § 3560.152 to remain eligible for occupancy.

(b) *Tenants no longer eligible.* Tenants who are no longer eligible for occupancy under the housing project's occupancy rules or do not meet the criteria set forth in § 3560.155(c) and (e) must vacate the property within 30 days of being notified by the borrower that they are no longer eligible for occupancy or at the expiration of their lease, whichever is greater, unless the conditions specified in paragraph (c) of this section exist.

(c) *Temporary continuation of tenancy.* If conditions described in § 3560.454(b) or the following conditions exist, borrowers may permit tenants who are no longer eligible for occupancy to continue to reside at the housing project with prior approval of the Agency.

(1) The waiting list for the specific rental unit type has no eligible applicants; or

(2) The required time period for vacating the rental unit would create a hardship on the tenant household.

(d) *Surviving and remaining household members.* (1) Members of a household may continue to reside in a housing project after the departure or death of the tenant or co-tenant, provided that:

(i) They are eligible with respect to adjusted income;

(ii) They occupied a rental unit in the housing project at the time of the departure or death of the tenant or co-tenant;

(iii) They execute a tenant certification form establishing their own tenancy; and

(iv) They have the legal ability to sign a lease for the rental unit, except where a legal guardian may sign when the tenant or member is otherwise eligible.

(2) Surviving or remaining members of the household may remain in the housing project, taking into consideration the conditions of paragraph (d)(1) of this section, but must move to a suitably sized rental unit within 30 days of its availability.

(3) After the death of a tenant or co-tenant in elderly housing, the surviving members of the household, regardless of age but taking into consideration the conditions of paragraph (d)(1) of this section, may remain in the rental unit in which they were residing at the time of the tenant's or co-tenant's death, even if the household is over housed according to the housing project's occupancy rules as follows:

(i) Continued occupancy of the rental unit will not be allowed when in either situation of paragraph (d)(1) or (d)(3) of this section, the rental unit has accessibility features for individuals with disabilities, the household no longer has a need for such accessibility features, and the housing project has a tenant application from an individual with a need for the accessibility features;

(ii) If the housing project does not have a tenant application from an individual with a need for the accessibility features, the household may remain in the rental unit with such features until the housing project receives an application from an individual with a need for accessibility features. The household in the unit with accessibility features will be required to move within 30 days of the housing project's receipt of a tenant application requiring accessibility features if another suitably sized unit without accessibility features is available in the project. If a suitably sized unit is not available in the project within 30 days, the tenant may remain in the unit with accessibility features until the first available unit in the project becomes available and then must move within 30 days.

**§ 3560.159 Termination of occupancy.**

(a) *Tenants in violation of lease.* Borrowers, in accordance with lease agreements, may terminate or refuse to renew a tenant's lease only for material non-compliance with the lease provisions, material non-compliance with the occupancy rules, or other good causes. Prior to terminating a lease, the borrower must give the tenant written

notice of the violation and give the tenant an opportunity to correct the violation. Subsequently, termination may only occur when the incidences related to the termination are documented and there is documentation that the tenant was given notice prior to the initiation of the termination action that their activities would result in occupancy termination.

(1) Material non-compliance with lease provisions or occupancy rules, for purposes of occupancy termination by a borrower, includes actions such as:

(i) Violations of lease provisions or occupancy rules that are substantial and/or repeated;

(ii) Non-payment or repeated late payment of rent or other financial obligations due under the lease or occupancy rules; or

(iii) Admission to or conviction for use, attempted use, possession, manufacture, selling, or distribution of an illegal controlled substance when such activity occurred on the housing project's premises by the tenant, a member of the tenant's household, a guest of the tenant, or any other person under the tenant's control at the time of the activity.

(2) Good causes, for purposes of occupancy terminations by a borrower, include actions such as:

(i) Actions by the tenant or a member of the tenant's household which disrupt the livability of the housing by threatening the health and safety of other persons or the right of other persons to enjoyment of the premises and related facilities;

(ii) Actions by the tenant or a member of the tenant's household which result in substantial physical damage causing an adverse financial effect on the housing or the property of other persons; or

(iii) Actions prohibited by state and local laws.

(b) *Lease expiration or tenant eligibility.* A tenant's occupancy in an Agency-financed housing project may not be terminated by a borrower when the lease agreement expires unless the tenant's actions meet the conditions described in paragraph (a) of this section, or the tenant is no longer eligible for occupancy in the housing. Borrowers must handle terminations of occupancy due to a change in tenant eligibility status in accordance with § 3560.158. At a minimum, the occupancy termination notice must include the following information:

(1) A specific date by which lease termination will occur;

(2) A statement of the basis for lease termination with specific reference to the provisions of the lease or occupancy

rules that, in the borrower's judgment, have been violated by the tenant in a manner constituting material non-compliance or good cause; and

(3) A statement explaining the conditions under which the borrower may initiate judicial action to enforce the lease termination notice.

(c) *Other terminations.* If occupancy is terminated due to conditions which are beyond the control of the tenant, such as a condition related to required repair or rehabilitation of the building, or a natural disaster, the tenants who are affected by such a circumstance are entitled to benefits under the Uniform Relocation Act and may request a Letter of Priority Entitlement (LOPE) from the Agency. If tenants need additional time to secure replacement housing, the Agency may, at the tenant's request, extend the LOPE entitlement period.

(d) *Criminal activity.* Borrowers may terminate tenancy for criminal activity or alcohol abuse by household members in accordance with the provisions of 24 CFR 5.858, 5.859, 5.860, and 5.861.

#### § 3560.160 Tenant grievances.

(a) *General.* (1) The requirements established in this section are designed to ensure that there is a fair and equitable process for addressing tenant or prospective tenant concerns and to ensure fair treatment of tenants in the event that an action or inaction by a borrower, including anyone designated to act for a borrower, adversely affects the tenants of a housing project.

(2) Any tenant/member or prospective tenant/member seeking occupancy in or use of Agency facilities who believes he or she is being discriminated against because of age, race, color, religion, sex, familial status, disability, or national origin may file a complaint in person with, or by mail to the U.S. Department of Agriculture's Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW., Washington DC 20250-9410 or to the Office of Fair Housing and Equal Opportunity, U.S. Department of Housing and Urban Development (HUD), Washington, DC 20410. Complaints received by Agency employees must be directed to the National Office Civil Rights Staff through the State Civil Rights Manager/Coordinator.

(b) *Applicability.* (1) The requirements of this section apply to a borrower action regarding housing project operations, or the failure to act, that adversely affects tenants or prospective tenants.

(2) This section does not apply to the following situations:

(i) Rent changes authorized by the Agency in accordance with the requirements of § 3560.203(a);

(ii) Complaints involving discrimination which must be handled in accordance with § 3560.2(b) and paragraph (a)(2) of this section;

(iii) Housing projects where an association of all tenants has been duly formed and the association and the borrower have agreed to an alternative method of settling grievances;

(iv) Changes required by the Agency in occupancy rules or other operational or management practices in which proper notice and opportunity have been given according to law and the provisions of the lease;

(v) Lease violations by the tenant that would result in the termination of tenancy and eviction;

(vi) Disputes between tenants not involving the borrower; and

(vii) Displacement or other adverse actions against tenant as a result of loan prepayment handled according to subpart N of this part.

(c) *Borrower responsibilities.*

Borrowers must permanently post tenant grievance procedures that meet the requirements of this section in a conspicuous place at the housing project. Borrowers also must maintain copies of the tenant grievance procedure at the housing project's management office for inspection by the tenants and the Agency upon request. Each tenant must receive an Agency summary of tenant's rights when a lease agreement is signed. If a housing project is located in an area with a concentration of non-English speaking individuals, the borrower must provide grievance procedures in both English and the non-English language. The notice must include the telephone number and address of USDA's Office of Civil Rights and the appropriate Regional Fair Housing and Enforcement Agency.

(d) *Reasons for grievance.* Tenants or prospective tenants may file a grievance in writing with the borrower in response to a borrower action, or failure to act, in accordance with the lease or Agency regulations that results in a denial, significant reduction, or termination of benefits or when a tenant or prospective tenant contests a borrower's notice of proposed adverse action as provided in paragraph (e) of this section. Acceptable reasons for filing a grievance may include:

(1) Failure to maintain the premises in such a manner that provides decent, safe, sanitary, and affordable housing in accordance with § 3560.103 and applicable state and local laws;

(2) Borrower violation of lease provisions or occupancy rules;

(3) Modification of the lease;  
 (4) Occupancy rule changes;  
 (5) Rent changes not authorized by the Agency according to § 3560.205; or  
 (6) Denial of approval for occupancy.  
 (e) *Notice of adverse action.* In the case of a proposed action that may have adverse consequences for tenants or prospective tenants such as denial of admission to occupancy and changes in the occupancy rules or lease, the borrower must notify the tenant or prospective tenant in writing. In the case of a Borrower's proposed adverse action including denial of admission to occupancy, the Borrower shall notify the applicant/tenant in writing. The notice must be delivered by certified mail return receipt requested, or a hand-delivered letter with a signed and dated acknowledgement of receipt from the applicant/tenant. The notice must give specific reasons for the proposed action. The notice must also advise the tenant or prospective tenant of "the right to respond to the notice within ten calendar days after date of the notice" and of "the right to a hearing in accordance with § 3560.160 (f), which is available upon request." The notice must contain the information specified in paragraph (a)(2) of this section. For housing projects in areas with a concentration of non-English speaking individuals, the notice must be in English and the non-English language.

(f) *Grievances and responses to notice of adverse action.* The following procedures must be followed by tenants, prospective tenants, or borrowers involved in a grievance or a response to an adverse action.

(1) The tenant or prospective tenant must communicate to the borrower in writing any grievance or response to a notice within 10 calendar days after occurrence of the adverse action or receipt of a notice of intent to take an adverse action.

(2) Borrowers must offer to meet with tenants to discuss the grievance within 10 calendar days of receiving the grievance. The Agency encourages borrowers and tenants or prospective tenants to make an effort to reach a mutually satisfactory resolution to the grievance at the meeting.

(3) If the grievance is not resolved during an informal meeting to the tenant or prospective tenant's satisfaction, the borrower must prepare a summary of the problem and submit the summary to the tenant or prospective tenant and the Agency within 10 calendar days. The summary should include: The borrower's position; the applicant/tenant's position; and the result of the meeting. The tenant also may submit a summary of the problem to the Agency.

(g) *Hearing process.* The following procedures apply to a hearing process.

(1) *Request for hearing.* If the tenant or prospective tenant desires a hearing, a written request for a hearing must be submitted to the borrower within 10 calendar days after the receipt of the summary of any informal meeting.

(2) *Selection of hearing officer or hearing panel.* In order to properly evaluate grievances and appeals, the borrower and tenant must select a hearing officer or hearing panel. If the borrower and the tenant cannot agree on a hearing officer, then they must each appoint a member to a hearing panel and the members selected must appoint a third member. If within 30 days from the date of the request for a hearing, the tenant and borrower have not agreed upon the selection of a hearing officer or hearing panel, the borrower must notify the Agency by mail of the situation. The Agency will appoint a person to serve as the sole hearing officer. The Agency may not appoint a hearing officer who was earlier considered by either the borrower or the tenant, in the interest of ensuring the integrity of the process.

(3) *Standing hearing panel.* In lieu of the procedure contained in paragraph (g)(2) of this section for each grievance or appeal presented, a borrower may ask the Agency to approve a standing hearing panel for the housing project.

(4) *Examination of records.* The borrower must allow the tenant the opportunity, at a reasonable time before a hearing and at the expense of the tenant, to examine or copy all documents, records, and policies of the borrower that the borrower intends to use at a hearing unless otherwise prohibited by law or confidentiality agreements.

(5) *Scheduling of hearing.* If a standing hearing panel has been approved, a hearing will be scheduled within 15 calendar days after receipt of the tenant's or prospective tenant's request for a hearing. If a hearing officer or hearing panel must be selected, a hearing will be scheduled within 15 calendar days after the selection or appointment of a hearing panel or a hearing officer. All hearings will be held at a time and place mutually convenient to both parties. If the parties cannot agree on a meeting place or time, the hearing officer or hearing panel will designate the place and time.

(6) *Escrow deposits.* If a grievance involves a rent increase not authorized by the Agency, or a situation where a borrower fails to maintain the property in a decent, safe, and sanitary manner, rental payments may be deposited by the tenant into an escrow account,

provided the tenant's rental payments are otherwise current.

(i) The escrow account deposits must continue until the complaint is resolved through informal discussion or by the hearing officer or panel.

(ii) The escrow account must be in a Federally-insured institution or with a bonded independent agent.

(iii) Failure to make timely rent payments into the escrow account will result in a termination of the tenant grievance and appeals procedure and all sums will immediately become due and payable under the lease.

(iv) Receipts of escrow account deposits must be available for examination by the borrower.

(7) *Failure to request a hearing.* If the tenant or prospective tenant does not request a hearing within the time provided by paragraph (f)(1) of this section, the borrower's disposition of the grievance or appeal will become final.

(h) *Requirements governing the hearing.* The following requirements will govern the hearing process.

(1) Subject to paragraph (f)(2) of this section, the hearing will proceed before a hearing officer or hearing panel at which evidence may be received without regard to whether that evidence could be used in judicial proceedings.

(2) The hearing must be structured so as to provide basic due process safeguards for both the borrower and the tenants or prospective tenants, which must protect:

(i) The right of both parties to be represented by counsel or another person chosen as their representative;

(ii) The right of the tenant or prospective tenant to a private hearing unless a public hearing is requested;

(iii) The right of the tenant or prospective tenant to present oral or written evidence and arguments in support of their grievance or appeal and to cross-examine and refute the evidence of all witnesses on whose testimony or information the borrower relies; and

(iv) The right of the borrower to present oral and written evidence and arguments in support of the decision, to refute evidence relied upon by the tenant or prospective tenant, and to confront and cross-examine all witnesses in whose testimony or information the tenant or prospective tenant relies.

(3) At the hearing, the tenant or prospective tenant must present evidence that they are entitled to the relief sought, and the borrower must present evidence showing the basis for action or failure to act against that

which the grievance or appeal is directed.

(4) The hearing officer or hearing panel must require that the borrower, the tenant or prospective tenant, counsel, and other participants or spectators conduct themselves in an orderly manner. Failure to comply may result in exclusion from the proceedings or in a decision adverse to the interests of the disorderly party and granting or denial of the relief sought, as appropriate.

(5) If either party or their representative fails to appear at a scheduled hearing, the hearing officer or hearing panel may make a determination to postpone the hearing for no more than five days or may make a determination that the absent party has waived their right to a hearing under this subpart. If the determination is made that the absent party has waived their rights, the hearing officer or hearing panel will make a decision on the grievance. Both the tenant or prospective tenant and the borrower must be notified in writing of the determination of the hearing officer or hearing panel.

(i) *Decision.* Hearing decisions must be issued in accordance with the following requirements.

(1) The hearing officer or hearing panel has the authority to affirm or reverse a borrower's decision.

(2) The hearing officer or hearing panel must prepare a written decision, together with the reasons thereof based solely and exclusively upon the facts presented at the hearing within 10 calendar days after the hearing. The notice must state that the decision is not effective for 10 calendar days to allow time for an Agency review as specified in paragraphs (i)(3) and (i)(4) of this section.

(3) The hearing officer or hearing panel must send a copy of the decision to the tenant, or prospective tenant, borrower, and the Agency.

(4) The decision of the hearing officer or hearing panel shall be binding upon the parties to the hearing unless the parties to the hearing are notified within 10 calendar days by the Agency that the decision is not in compliance with Agency regulations.

(5) Upon receipt of written notification from the hearing officer or hearing panel, the borrower and tenant must take the necessary action, or refrain from any actions, specified in the decision.

#### §§ 3560.161–3560.199 [Reserved]

#### § 3560.200 OMB control number.

The information collection requirements contained in this

regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

#### Subpart E—Rents

##### § 3560.201 General.

This subpart sets forth the requirements for establishing and collecting rents charged to occupants of multi-family housing (MFH) projects financed by the Agency.

##### § 3560.202 Establishing rents and utility allowances.

(a) *General.* Rents and utility allowances for rental units in Agency-financed housing projects are set by the borrower and must be based on the operating, management and maintenance expenses and other costs related to the housing project including loan payment amounts due to the Agency.

(b) *Agency approval.* All rents and utility allowances set by borrowers are subject to Agency approval.

(c) *Rents.* As applicable, borrowers must establish the following rents:

(1) Note rent;

(2) Basic rent;

(3) U.S. Department of Housing and Urban Development (HUD) contract rents; and

(4) Low-income housing tax credit (LIHTC) rents.

(d) *Utility allowances.* In projects where tenants pay the utilities, borrowers must establish utility allowances for each size and type of rental unit in the housing project based on estimated utility costs. Borrowers must review utility allowances annually, adjust for accuracy, and submit any utility allowance changes to the Agency for approval. If no changes are needed, the borrower must notify the Agency that no changes were made. Documentation to justify utility allowances must be maintained in the housing project files.

(e) *Funds contributed to reduce rents.* If borrowers use funds contributed from sources other than the Agency (e.g., state or local grants, private contributions) to reduce general

operating and management expenses, housing project rents must be reduced to reflect the funding being used to offset housing project expenses. When funds contributed from sources other than the Agency are used for housing project expenses, the borrower must certify to the Agency, in writing, that the funds provided will not need to be repaid with Agency funds. Funds from borrower contributions or rehabilitation loans will not be counted towards reducing rents.

(f) *Rents for resident manager, caretaker, or owner-occupied unit.*

(1) If approved as a part of a management plan, a borrower may occupy a rental unit in a housing project when they are acting as a management agent or resident manager as specified in § 3560.102(e).

(2) If the rental unit being occupied by a borrower or resident manager is designated as a revenue-producing unit, borrowers must calculate the rental charge to the borrower or resident manager in the same manner as tenant contributions.

(3) If the rental unit being occupied by a borrower or resident manager is designated as a non-revenue producing unit, borrowers must treat the cost of providing the unit the same as other non-revenue producing portions of the housing project.

(g) *LIHTC.* Borrowers who receive LIHTCs may establish rents in accordance with LIHTC requirements. However, borrowers are obligated to ensure that sufficient annual funds are available to cover expenses in the housing project's approved budget, including the required payments on the borrower's Agency loan. Borrowers must not use housing project funds to make up any difference between rents required under Agency program requirements and the maximum allowed rents under the LIHTC program.

##### § 3560.203 Tenant contributions.

(a) *Tenant contributions.* A tenant's contribution to rent charged for a rental unit in an Agency financed housing project is based on the tenant's income, as calculated on the Agency's tenant certification forms, and the availability of Agency or non-Agency rental subsidies.

(1) *Tenant contributions.* Borrowers must set tenant contributions to rent at the highest of the following standards but never more than the note rent:

(i) Thirty percent of monthly adjusted income;

(ii) Ten percent of gross monthly income;

(iii) An amount equal to the portion of an assistance payment specifically

designated to meet the household's shelter costs if the household is receiving assistance payments from a public agency; or

(iv) The basic rent, unless RHS rental assistance is provided to the household.

(2) *Tenant contribution surcharge.* Tenants in a Plan I housing project with incomes above the eligibility standards set in § 3560.152(a)(1) must pay a 25 percent surcharge in addition to note rent.

(b) *Adjustment of tenant contribution.* Borrowers must adjust the tenant contribution whenever there is a change in tenant household status or income sufficient to generate a revised tenant certification in accordance with § 3560.152(e) or an Agency approved rent or utility allowance change that affects the tenant contribution amount.

(c) *Overage.* If a tenant's tenant contribution is higher than basic rent, borrowers must remit to the Agency the rent collected in excess of the basic rent and up to the note rent.

#### **§ 3560.204 Security deposits and membership fees.**

(a) *General.* Borrowers may collect security deposits when it is reasonable and customary for the area in which the housing is located. Borrowers must hold security deposits in a separate bank or bookkeeping account in accordance with § 3560.302(c)(3).

(b) *Allowable amounts.* Borrowers may charge security deposits that are typical for the area in which the housing is located, as long as the security deposit charged a tenant does not exceed that tenant's net contribution for one month's rent or basic rent, whichever is greater.

(1) As noted in § 3560.102(b)(1)(viii) and § 3560.156(c)(18)(iii), borrowers must specify in the housing project's management plan how the amount to be charged as a security deposit will be established and must specify the amount to be charged to individual tenants in the lease to be signed by the tenant.

(2) Borrowers may charge security deposits to households receiving HUD assistance in accordance with HUD requirements.

(3) Members of a cooperative shall be required to pay a membership fee no greater than one month's occupancy charge.

(4) Additional security deposits for pets may be charged as long as the additional deposit is not greater than basic rent for 1 month. No additional security deposit for assistance animals is allowed where an assistance animal is necessary for the normal functioning of a household member with a disability.

(5) Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

(c) *Payment plans.* Borrowers must offer, for persons who are eligible for rental assistance or Section 8 assistance, the option of paying the security deposit on an installment payment plan. Should installments not be met, the total charge may become due and payable in full.

(d) *Charges for damage or loss.* Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

(1) Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

(2) Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts.

(e) *State and local security deposit requirements.* Borrowers must follow all state and local laws and other requirements governing the handling and disposition of security deposits.

(1) Resolution of any security deposit disputes must be handled in accordance with state and local law.

(2) Any interest earned on security deposits will accrue in accordance with state law.

(f) *Unclaimed security deposits.* Any funds in the housing project's security deposit account unclaimed by a tenant must be deposited into the housing project's general operating account.

#### **§ 3560.205 Rent and utility allowance changes.**

(a) *General.* Borrowers must fully document that changes to rents and utility allowances are necessary to cover housing or utility costs allowed under the approved budget for the housing. Any changes must apply to all similar units in the housing project.

(b) *Agency approval.* Borrowers must submit a fully documented request to the Agency to effect any rent or utility allowance change.

(1) Borrowers must obtain written consent or approval from the Agency as specified in paragraph (e) of this section before implementing any changes in the rents or utility allowances.

(2) If a borrower implements an unauthorized rent or utility allowance charge, the Agency will require the borrower to roll back rents to the last authorized rent charge, and the borrower must reimburse tenants for any unauthorized rents collected.

(c) *Timing of request for changes.* Borrowers must submit rent and utility

allowance change requests in conjunction with the annual budget submission as required under § 3560.303(d). The effective dates of any approved changes will coincide with the start of the housing project's fiscal year or the start of the season for seasonally occupied farm labor housing. However, the Agency will accept borrower requests for rent or utility allowance changes anytime during the year if a change is necessary to preserve the financial integrity of the housing complex and the financial distress is due to circumstances beyond the borrower's control.

(d) *Tenant notification.* Borrowers must notify tenants and solicit their comments to proposed rent or utility allowance change requests that are submitted to the Agency at the same time that the initial request is made to the Agency.

(1) Tenants will be given 20 calendar days to provide their comments to the Agency.

(2) Borrowers must deliver the proposed rent or utility allowance change request notice to each tenant and post at least one copy of the notice at the housing project site in a visible location frequented by tenants.

(e) *Approval.* If the Agency approves a rent or utility allowance increase request on which the comments were solicited, the borrower will deliver a notice announcing the rent or utility allowance change to the tenants to be effective 30 calendar days from the date of the notification.

(f) *Denial of change request.* The Agency may deny a rent or utility allowance increase request in the following circumstances.

(1) The Agency determines that the borrower did not provide sufficient information to justify operating costs.

(2) The borrower is out of compliance with Agency requirements including any corrective action requirements agreed to in a workout agreement developed according to subpart J of this part.

(3) Sufficient funds are being collected under existing rents to meet approved expenses.

(g) *Notice of denial.* If the rent change will not be approved as requested, the Agency will notify the borrower of the denial in accordance with § 3560.303(d).

#### **§ 3560.206 Conversion to Plan II (Interest Credit).**

The Agency encourages any borrower not on Plan II to convert to Plan II to provide more favorable rent costs to very-low, low, and moderate-income households.

**§ 3560.207 Annual adjustment factors for Section 8 units.**

(a) *General.* For rental units receiving project-based Section 8 assistance, the Agency will review rents annually without regard to HUD's automatic annual adjustment.

(b) *Establishing rents in housing with HUD rent assistance.* Borrowers will set note and basic rents for housing receiving HUD project based Section 8 assistance, as specified in § 3560.202(c)(3).

(1) Borrowers must notify the Agency of any HUD rent changes.

(2) If allowed by the interest credit agreement, the borrower will remit the amount collected in excess of the basic rent up to the note rent to the Agency as overage.

(3) When HUD contract rents exceed note rents, borrowers must deposit HUD funds equal to the difference between the Agency approved note rent and the HUD approved rent into the reserve account for the housing project.

(c) *Excess HUD rents.* When permitted by the Agency interest credit agreement, the Agency may reduce or cancel the interest credit on the housing, if excess HUD rents deposited in the reserve account result in the reserve account being funded beyond the fully funded level approved by the Agency.

**§ 3560.208 Rents during eviction or failure to recertify.**

(a) *Rents during eviction.* If a tenant is appealing an eviction and the borrower refuses to accept rent payment during the appeal of the eviction, the tenant must escrow required rent payments to safeguard their occupancy, unless State or local laws specify otherwise.

(b) *Rents when tenants fail to recertify.* If a borrower can document that a tenant received a notice specifying a tenant recertification date and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, shall give the tenant and the Agency written notification that:

(1) Termination proceedings are being initiated, in accordance with § 3560.159; and

(2) The tenant will be charged note rent until the tenant's lease is terminated.

(c) *Unauthorized assistance due to tenant recertification failure.* Any unauthorized assistance received because of the tenant's failure to be

recertified will be collected in accordance with the provisions of subpart O of this part.

(d) *Rents when borrowers fail to recertify tenants.* If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants shall continue to make net tenant contributions to rent based on their most recent tenant certification and the borrower must remit to the Agency full overage as if the tenant was paying the note rent until the tenant is recertified.

(e) *Unauthorized assistance due to borrower recertification failure.* Any unauthorized assistance received as a result of the borrower's failure to recertify a tenant will be collected from the borrower in accordance with the provisions of subpart O of this part and may not be paid from housing project funds or funds collected from the tenant.

**§ 3560.209 Rent collection.**

(a) *General.* Borrowers must collect rents on a monthly basis and maintain a system for collecting and tracking rents.

(b) *Fees for late rent payments.* Borrowers may adopt a late fee schedule for overdue rental payments. Late fee schedules must be submitted to the Agency for approval as part of the housing project's management plan, be in accordance with State and local law, and consistent with the following requirements:

(1) A grace period of 10 days from the rental payment due date must be allowed for all tenants.

(2) The late fee must not exceed the higher of \$10 or an amount equal to 5 percent of the tenant's gross tenant contribution.

(3) Tenants receiving housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

(c) *Improperly advanced rents.* Improperly advanced interest credit or rental assistance is considered unauthorized assistance and is subject to recapture in accordance with subpart O of this part.

**§ 3560.210 Special note rents (SNRs).**

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge an SNR, which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent.

The requirements for requesting and receiving an SNR are established under § 3560.454.

**§§ 3560.211–3560.249 [Reserved]****§ 3560.250 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart F—Rental Subsidies****§ 3560.251 General.**

This subpart contains policies for borrower administration and tenant use of rental subsidies in Agency financed multi-family housing (MFH) projects.

**§ 3560.252 Authorized rental subsidies.**

(a) *General.* The purpose of rental subsidies is to reduce amounts paid by tenants for rent. Rental subsidies equal the difference between the approved shelter costs and tenant contributions as calculated in accordance with § 3560.203(a)(1).

(b) *Forms of rental subsidies.* Rental subsidies may be in the form of:

- (1) Agency rental assistance;
- (2) HUD section 8 assistance, including project-based and vouchers;
- (3) Private rental subsidies; or
- (4) State or local government rental subsidies.

(c) *Multiple rent subsidies.* (1) Multiple types of rent subsidies may be used in the same MFH project.

(2) Tenants with subsidies from sources other than the Agency may be eligible for Agency rental assistance if the following conditions are met.

(i) The tenant qualifies for Agency rental assistance.

(ii) The rental subsidy the tenant is receiving is not a HUD voucher.

(iii) The rental subsidy being received by the tenant is less than the full amount of Agency rental assistance for which the tenant would qualify. In such cases, the Agency may provide the difference between the subsidy received by the tenant and the amount of Agency rental assistance for which the tenant qualifies.

(d) *Agency rental assistance (RA)*. Agency RA is obligated to MFH projects on a rental unit basis. The obligation is composed of a number of rental units and associated dollar amounts of RA specified in a RA agreement with a borrower. The following types of Agency RA may be obligated to a housing project.

(1) *Renewal units*. RA may be assigned to a housing project to replace existing rental unit obligations because funds associated with the units have been fully disbursed.

(2) *New construction units*. RA may be provided in conjunction with initial Agency loans for construction or substantial rehabilitation of MFH projects.

(3) *Servicing units*. Additional RA may be provided to operational MFH projects as a part of the Agency's general loan servicing or preservation activities.

#### § 3560.253 [Reserved]

#### § 3560.254 Eligibility for rental assistance.

(a) *Eligible housing*. Housing projects eligible for Agency RA include the following types of projects.

(1) Housing projects that operate under an Interest Credit Plan II RA agreement.

(2) Housing projects financed with an Agency off-farm labor housing loan or grant. On-farm labor housing is not eligible for rental assistance.

(3) Housing projects financed with a direct or insured Rural Rental Housing loan approved prior to August 1, 1968, and operated under an interest credit agreement that identifies the housing project as a Plan RA project.

(4) Housing projects financed from Agency and other sources if the conditions of § 3560.66 are met.

(b) *Eligible units*. Borrowers may not request RA for rental units that the Agency determines are not habitable in accordance with § 3560.103.

(c) *Eligible households*. Households eligible for rental assistance are those:

(1) With very low-or low-incomes who are eligible to live in MFH;

(2) Whose net tenant contribution to rent determined in accordance with § 3560.203(a)(2) is less than the basic rent for the unit;

(3) Whose head of the household is a U.S. citizen or a legal alien as defined in § 3560.11;

(4) Who meet the occupancy rules established by the borrower in accordance with § 3560.155(e); and

(5) Who have a signed, unexpired tenant certification form on file with the borrower.

#### § 3560.255 Requesting rental assistance.

(a) *Submitting requests*. Borrowers seeking an allocation of rental assistance for MFH must request the rental assistance from the Agency as follows.

(1) *Renewal rental assistance*. To the extent sufficient funds are available, the Agency will automatically renew expiring rental assistance agreements at the existing number of units.

(2) *New construction units*. Loan applicants proposing to use Agency rental assistance must include their request for rental assistance in their loan proposal in accordance with § 3560.56.

(3) *Servicing units*. Borrowers requesting rental assistance must have tenants or eligible tenant applicants on a waiting list who are RA eligible.

(b) *Denial of requests*. (1) If a rental assistance request is denied due to the loan applicant's or borrower's ineligibility, the Agency will send the loan applicant or borrower written notification of the decision with an explanation of the denial.

(2) If a rental assistance request to renew expiring rental assistance agreements is denied because funding is not available, the Agency will notify the borrower and the borrower must notify the tenants of rent increases in accordance with their lease and state and local law. Tenants losing rental assistance due to a lack of Agency funding may quit the lease and vacate the housing without penalty in accordance with the terms of their lease.

(3) Loan applicants or borrowers determined to be eligible for RA as a result of an appeal or funding review will receive RA, if RA funding is available, beginning with the month following the date of the appeal or funding review decision or beginning in the first month that RA funding becomes available.

#### § 3560.256 Rental assistance payments.

(a) *Borrower submission requirements*. The borrower must submit monthly requests for RA payments to the Agency based on occupancy as of the first day of the month previous to the month in which the request is being made.

(b) *Basis of RA requests*. Borrower requests for RA payments must be based on the difference between the basic rent plus utility allowances for each rental unit eligible for RA and the net tenant contribution of the tenant.

(c) *Payments to borrower*. Prior to making RA payments to a borrower, the Agency will deduct from the approved RA payment amount any unpaid loan payments, late fees, and other amounts which the borrower owes to the Agency.

(d) *Utility payments to tenants*. The borrower must pay tenants the

difference between the utility allowance and the tenant's net contribution to rent when a tenant receiving RA is billed directly for utilities and the utility allowance exceeds the net tenant contribution to rent. Such utility payments to tenants must be made on a monthly basis.

(e) *Administrative errors*. Borrowers are responsible for correcting borrower errors made in regard to RA requests for payments. In accordance with subpart O of this part, borrowers will be required to repay the Agency for any unauthorized RA received or any unauthorized use of RA except in certain cases of tenant error or fraud.

#### § 3560.257 Assigning rental assistance.

(a) *Priorities for rental assistance*. (1) Borrowers must use the following priorities when assigning available rental assistance.

(i) First priority is to eligible very low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(ii) Second priority, if the housing project has vacant rental units, is to eligible very low-income applicants on the waiting list.

(iii) Third priority is to eligible low-income tenants paying the highest percentage of their adjusted annual income for Agency approved shelter costs.

(iv) Fourth priority, if the housing project has vacant rental units, is to eligible low-income applicants on the waiting list.

(v) Fifth priority is to households which are residing in a rental unit for which they do not qualify on the basis of an occupancy waiver or other special approval situations.

(2) In order to provide rental assistance to the third, fourth, and fifth priority categories, a borrower must fully document either that there are no very low-income households on the housing project's waiting list or that occupancy by low-income households is limited as follows:

(i) For housing occupied on or after November 30, 1983, no more than 5 percent of the units in the housing are occupied by low-income households; or

(ii) For housing occupied before November 30, 1983, no more than 25 percent of the units in the housing are occupied by low-income households.

(b) *Continued eligibility*. Tenants receiving rental assistance may continue to do so as long as they remain eligible for occupancy and for rental assistance under § 3560.254(c), and as long as rental assistance units are available.

(c) *Assignment of rental assistance.* Except as provided in § 3560.454(c) and using the priorities given in paragraph (a) of this section, borrowers must assign available rental assistance units as soon as rental assistance units become available.

(1) When a rental assistance unit is assigned to an eligible existing tenant on a day other than the first day of a month, the Agency will not provide the borrower rental assistance for the newly assigned existing tenant and the tenant will not pay reduced rental charges until the first of the month following the assignment of the rental assistance.

(2) When an eligible applicant moves into a rental assistance unit on a day other than the first day of a month, they will pay a prorated rent based on the number of days they occupy the rental assistance unit and the amount of rental assistance they will be receiving.

(d) *Incorrectly assigned rental assistance.* Incorrectly assigned rental assistance is viewed as unauthorized assistance and handled in accordance with subpart O of this part.

#### § 3560.258 Terms of agreement.

(a) *Term of agreement.* Rental assistance agreements will be consistent with available funding. Rental assistance agreements expire when the funds obligated for rental assistance units are fully disbursed in accordance with the conditions of the agreement.

(b) *Replacing expiring obligations.* To the extent funds are available for replacement units, the Agency will renew rental assistance agreements.

#### § 3560.259 Transferring rental assistance.

(a) *Agency authority.* The Agency may transfer rental assistance in the following instances:

(1) To accompany the transfer of a housing project to a different borrower;

(2) After a voluntary conveyance or a foreclosure sale;

(3) After a liquidation or prepayment;

(4) To the extent permitted by law, when any rental assistance units have not been used for a 6-month period; or

(5) When the loan cannot be closed.

(b) *Agency review before transferring rental assistance.* The Agency must perform a review to determine if all eligible tenants in the project are receiving rental assistance before the Agency transfers it to another project.

(c) *Transferring rental assistance for displaced tenants.* The Agency may transfer rental assistance from one housing project to another eligible housing project for a tenant who is moving due to displacement as a result of prepayment, liquidation, or a natural disaster. The tenant must begin using

the rental assistance within 4 months of the transfer or the RA will become available for use by the next rental assistance eligible tenant in the housing project.

#### § 3560.260 Rental subsidies from non-Agency sources.

(a) *General.* The Agency may authorize the use of rental subsidies from sources other than the Agency in Agency financed housing projects. The Agency will make no commitment to providing Agency rental assistance at the expiration of the rental subsidies from other sources.

(b) *HUD vouchers.* For tenants with HUD vouchers, the borrower must set the rental unit rent at the basic rent or the rent standard set by the public housing authority, whichever is less. The public housing authority distributing the HUD vouchers may set the utility allowance.

(c) *Loan proposals using non-Agency rental subsidy.* Loan applicants or borrowers proposing to use rental subsidy from sources other than the Agency must provide:

(1) Documentation demonstrating that a market exists for households eligible for the subsidy and the households are at income levels that would benefit from the amount of rental subsidy that will be provided;

(2) A plan describing actions to be taken when the rental subsidy expires to minimize the impact on tenants losing the rental assistance and to avoid displacement; and

(3) A copy of the project-based rental assistance agreement to be signed by the borrower and the provider of the rental assistance.

(d) *Rental subsidy agreement.* The borrower and the provider of rental subsidies from sources other than the Agency must execute a rental subsidy agreement and submit a copy of the agreement to the Agency. At a minimum, the rental subsidy agreement between the borrower and the source of the rental subsidy must include the following provisions:

(1) A description of how the subsidy will be paid. The rental subsidy payments may be paid directly to the tenants, to the borrower on behalf of the tenants, or deposited to a separate account established for the subsidy. The tenants must be advised of the amount and source of the subsidy through the lease or a supplement to the lease.

(2) The life of a project-based rental subsidy agreement with a non-Agency source must be similar to existing or current Agency rental assistance funding levels and sufficient funds must be set aside to assure availability of the

rental subsidy for this term. The method of supplying the funds must be clearly established.

#### § 3560.261 Improperly advanced rental assistance.

Improperly advanced RHS rental assistance resulting from tenant or borrower error or fraud constitutes unauthorized assistance and the provisions of subpart O of this part apply.

#### §§ 3560.262–3560.299 [Reserved]

#### § 3560.300 OMB control number.

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#### Subpart G—Financial Management

#### § 3560.301 General.

This subpart contains requirements for the financial management of Agency-financed multi-family housing (MFH) projects, including accounts, budgets, reports, and engagements. Financial management systems and procedures must cover all housing operations and provide adequate documentation to ensure that program objectives are met.

#### § 3560.302 Accounting, bookkeeping, budgeting, and financial management systems.

(a) *General.* Borrowers must establish the accounting, bookkeeping, budgeting and financial management procedures necessary to conduct housing project operations in a financially safe and sound manner. Borrowers must maintain records in a manner suitable for an engagement and must be able to report accurate operational results to the Agency from these accounts and records.

(b) *Acceptable methods of accounting.*

(1) Borrowers may use a cash, accrual, or modified accrual method of accounting, bookkeeping, and budget preparations as long as the method is consistent with the statements required by the engagement in accordance with the standards identified in § 3560.308.

(2) Borrowers must describe their accounting, bookkeeping, budget preparation, and financial reporting procedures, including Agency-approved engagements, in their management plan.

(3) Borrowers must notify the Agency of any changes in their accounting, bookkeeping, budget preparation, and financial management reporting systems through a revision of their management plan.

(c) *Account requirements.* (1) As used in this paragraph, the term account is used interchangeably to mean a bookkeeping account (ledger) or a bank account.

(2) At a minimum, borrowers must maintain the accounts required by their loan agreement or resolution.

(3) The following list identifies the financial accounts that are required for each housing project. Additional accounts may be required by third-party lenders. Accounts are to be funded in the following priority order, except that paragraphs (c)(3)(iv), (v), and (vi) of this section are funded directly by tenant security deposits or patron capital receipts respectively:

- (i) General operating account;
- (ii) Real estate tax and insurance account (if not part of the general operating account);
- (iii) Reserve account;
- (iv) Tenant security deposit account;
- (v) Membership fee account for cooperative housing; and
- (vi) For cooperative housing only, a patron capital account.

(4) Amounts escrowed for taxes and insurance may be kept in the general operating account as long as the accounting system reflects the amount escrowed.

(5) Regardless of the number or types of accounts established, the borrower must meet the following requirements:

(i) All housing project funds must be held only in financial institution accounts insured by an agency of the Federal Government, backed by collateral provided by the bank, or held in securities meeting the conditions in this subpart.

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

(iii) All funds and proceeds in any account must be used only for authorized purposes as described in Agency's regulations, loan or grant documents. Use of funds for non-program purposes constitutes non-

monetary default as described in § 3560.452(c).

(iv) All funds received and held in any account, except the tenant security deposit, membership fee, and patron capital accounts, must be held in trust by the borrower for the loan obligation until used and serve as security for the Agency loan or grant.

(v) Borrowers must be able to account for housing project funds with accounting methods or practices that maintain the proprietary identity of the funds for each project. A borrower may operate one account for multiple projects as long as the funds for each project themselves are accounted for separately.

(vi) Each borrower must have access to at least one demand deposit or checking account.

(vii) Housing project funds may not be pledged as collateral for debts without Agency approval. If such a need arises for an eligible program purpose, the borrower must obtain prior Agency approval.

(6) Tenant security deposit accounts or membership fee accounts and patron capital accounts must be maintained in a separate account in trust for the tenants or members and handled in a manner consistent with state and local laws.

(d) *Documentation of separate accountability.* Housing project funds may be combined in one or more bank accounts for two or more housing projects as long as the borrower's accounting system segregates and tracks funds for each project separately.

(1) When borrowers request Agency approval of an accounting system that combines funds from two or more housing projects, they must demonstrate to the Agency that the accounting systems are structured to segregate and maintain separate accountability for each housing project. Such demonstration must include a statement issued by a Certified Public Accountant (CPA) stating that the accounting system is structured to meet this principle of separate accountability.

(2) The accounting system and management plan must document the method for prorating revenue and expenses that are not clearly identifiable as being associated with a particular housing project.

(3) Funds for housing projects managed by the same management company must not be co-mingled.

(e) *Records.* (1) Borrowers must retain all housing project financial records, books, and supporting material for at least three years after the issuance of the engagement and financial reports. Upon request, these materials will

immediately be made available to the Agency, its representatives, the USDA Office of the Inspector General (OIG), or the General Accountability Office (GAO).

(2) Borrower accounts and records will be kept or made available in a location with reasonable access for inspection, review, and copying by the Agency, other authorized representatives of the USDA, OIG, or GAO.

(3) Automated records may be used if they meet the conditions of paragraph (f) of this section.

(f) *Forms generated by automated systems.* (1) The forms and formats approved for use by borrowers may be prepared on automated systems when they meet the requirements of this paragraph.

(2) Forms may be automated if they meet the following requirements:

(i) The identical wording and nomenclature of an official form must be included in the automated version of the form, including the Office of Management and Budget (OMB) approval number.

(ii) The logic or mathematical calculation of an official form must be the same in an automated version of the form.

(iii) The name or logo of the source of the automated form must be visible on each output of the automated form.

(iv) Output size must be 8½ × 11 inches.

(v) Nominal spacing adjustment and colored paper are allowed.

(g) *Farm Labor Housing.* Borrowers with on-farm labor housing units will be considered in compliance with this section by virtue of completing the record keeping and reporting requirements outlined in subpart M of this part.

#### § 3560.303 Housing project budgets.

(a) *General requirements.* (1) Using an Agency-approved format, borrowers must submit to the Agency for approval a proposed annual housing project budget prior to the start of the housing project's fiscal year. The capital budget section of the annual project budget must include anticipated expenditures on the project's long-term capital needs as specified in § 3560.103(c).

(2) Budget projections regarding income, expenses, vacancies, and contingencies must be realistic given the housing project's history, current circumstances, and market conditions.

(3) Borrowers must document that the operating expenses included in the budget accurately reflect reasonable and necessary costs to operate the housing project in a manner consistent with the

objectives of the loan and in accordance with the applicable Agency requirements.

(4) Borrower must submit supporting documentation to justify housing project utility allowances.

(5) Upon Agency request, borrowers must submit any additional documentation necessary to establish that applicable Agency requirements have been met.

(b) *Allowable and unallowable project expenses.* Expenses charged to project operations, whether for management agent services or other expenses, must be reasonable, typical, necessary and show a clear benefit to the residents of the property. Services and expenses charged to the property must show value added and be for authorized purposes.

(1) *Allowable expenses.* Allowable expenses include those expenses that are directly attributable to housing project operations and are necessary to carry out successful operations.

(i) Housing project expenses must not duplicate expenses included in the management fee as defined in § 3560.102(i).

(ii) Actual costs for direct personnel costs of permanent and part-time staff assigned directly to the project site. This includes managers, maintenance staff, and temporary help including their:

- (A) Gross salary;
- (B) Employer FICA contribution;
- (C) Federal unemployment tax;
- (D) State unemployment tax;
- (E) Workers compensation insurance;
- (F) Health insurance premiums;
- (G) Cost of fidelity or comparable insurance;

(H) Leasing, performance incentive or annual bonuses;

(I) Direct costs of travel to off-site locations by on-site staff for property business or training; and/or

(J) Retirement benefits.

(iii) Legal fees directly related to the operation and management of the property including tenant lease enforcement actions, property tax appeals and suits, and the preparation of all legal documents.

(iv) All outside account and auditing fees, if required by the Agency, directly related to the preparation of the annual audit, partnership tax returns and 401-K's, as well as other outside reports and year-end reports to the Agency, or other governmental agency.

(v) All repair and maintenance costs for the project including:

- (A) Maintenance staffing costs and related expenses.
- (B) Maintenance supplies.
- (C) Contract repairs to the projects (e.g., heating and air conditioning, painting, roofing).

(D) Make ready expenses including painting and repairs, flooring replacement and appliance replacement as well as drapery or mini-blind replacement. (Turnover maintenance).

(E) Preventive maintenance expenses including occupied unit repairs and maintenance as well as common area systems repairs and maintenance.

(F) Snow removal.

(G) Elevator repairs and maintenance contracts.

(H) Section 504 and other Fair Housing compliance modifications and maintenance.

(I) Landscaping maintenance, replacements, and seasonal plantings.

(J) Pest control services.

(K) Other related maintenance expenses.

(vi) All operational costs related to the project including:

(A) The costs of obtaining and receiving credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

(B) The cost of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.

(C) All bank charges related to the property including purchases of supplies (e.g., checks, deposit slips, returned check fees, service fees).

(D) Costs of site-based telephone including initial installation, basic services, directory listings, and long-distances charges.

(E) All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.

(F) Postage and delivery costs from the site including expenses to the Agency or other governmental agencies, tenants, verifying third parties, central management offices, etc.

(G) Partnership or corporate business expenses including state taxes and other mandated state or local fees as well as other relevant expenses required for operation of the property by a third-party governmental unit. Costs of continuation financing statements and site license and permit costs.

(H) Expenses related to site utilities including actual costs and surcharges as well as deposits and expense of utility bonds in lieu of bonds.

(I) Site office furniture and equipment including site based computer and copiers. Service agreements and warranties for copiers, telephone systems and computers are also included (if approved by the Agency).

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

(K) All costs of insurance including property liability and casualty as well as fidelity or crime and dishonesty coverage for on-site employees and the owners.

(L) Costs of collecting rents on-site including bookkeeping supplies and recordkeeping items.

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

(N) Public relations expense relative to maintaining positive relationships between the local community and the tenants with the management staff and the borrowers. Chamber of Commerce dues, contributions to local charity events, and sponsorship of tenant activities, are examples.

(O) Tax Credit Compliance Monitoring Fees imposed by HFAs.

(P) All insurance deductibles as well as adjuster expenses.

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

(R) On-site training pre-approved by the Agency provided by outside training vendors.

(S) Site manager salary for additional hours associated with congregate housing.

(vii) With prior Agency approval, cooperatives and nonprofit organizations may use housing project funds to pay asset management expenses directly attributable to ownership responsibilities. Such expenses may include:

(A) Errors and omissions insurance policy for the Board of Directors.

(B) Board of Director review and approval of proposed Agency's annual operating budgets, including proposed repair and replacement outlays and accruals.

(C) Board of Director review and approval of capital expenditures, financial statements, and consideration of any management comments noted.

(D) Long-term asset management reviews.

(2) *Unallowable expenses.* Housing project funds may not be used for any of the following:

(i) Equity skimming as defined in 42 U.S.C. 543 (a).

(ii) Purposes unrelated to the housing project.

(iii) Reimbursement of inaccurate or false claims.

(iv) Settlement agreements, court ordered decrees, legal fees, or other costs that result from the filing of civil rights complaints or legal action alleging the borrower, or a representative of the borrower, has committed a civil rights violation.

(v) Fines, penalties, and legal fees where the borrower or a borrower's representative has been found guilty of violating laws, including, but not limited to, civil rights, and building codes.

(vi) Association dues to be paid by the project should be related to training for site managers or management agents. To the extent that association dues can document training for site managers or management agents related to project activities by actual cost or pro-ratio, a reasonable expense may be billed to the project.

(vii) Pay for bonuses or monetary performance awards to site managers or management agents that are not clearly provided for by the site manager salary contract.

(viii) Billing for parties that are large or unreasonable, such as renting expensive party halls or hotel rooms and payment for alcoholic beverages or gifts to management agent staff.

(ix) Billing for practices that are inefficient such as routine use of collect calls from a site manager to a management agent office.

(c) *Priorities.* The priority order of planned and actual budget expenditures will be:

- (1) Senior position lienholder, if any;
- (2) Operating and maintenance expenses, including taxes and insurance;
- (3) Agency debt payments;
- (4) Reserve account requirements;
- (5) Other authorized expenditures;

and

(6) Return on owner investment.  
(d) *Agency review and approval.* (1) The Agency will only approve housing project budgets that meet the requirements of paragraphs (a), (b) and (c) of this section.

(2) If no rent change is requested, borrowers must submit budget documents for Agency approval 60 calendar days prior to the start of the housing project's fiscal year. The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section. The borrower will have 10 days to submit the additional material.

(3) If a rent change is requested, the borrower must submit budget documents to the Agency and notify tenants of the requested rent change at

least 90 calendar days prior to the start of the housing project's fiscal year.

(i) The Agency will notify borrowers if the budget submission does not meet the requirements of paragraphs (a), (b), and (c) of this section, or if the rent and utility allowance request has been denied in accordance with § 3560.205(f). The borrower will have 10 days to submit the additional material to address any issues raised by the Agency.

(ii) The rent change is not approved until the Agency issues a written approval. If there is no response from the Agency within the 30-day period, the rent change is considered automatic. The following budgets are not eligible for automatic approval:

(A) Budgets with rent increases above \$25 per unit; and

(B) Budgets that are submitted late or that miss other deadlines set by the Agency.

(4) If the Agency denies the budget approval, the Agency will notify the borrower in writing.

(5) If budget approval is denied, the borrower shall continue to operate the housing project on the basis of the most recently approved budget.

#### § 3560.304 Initial operating capital.

(a) *Purpose.* To provide a source of capital for start-up costs, such as the purchase of equipment, and paying operating, maintenance, and debt service expenses. Borrowers are required to make an initial operating capital contribution to the general operating account as described in § 3560.64.

(b) *Authorized uses of initial operating capital.* Initial operating capital may be used only to pay for approved budgeted expenses.

(c) *Withdrawal of initial operating capital.* Initial operating capital funds may be withdrawn by a borrower if:

(1) The initial operating capital was provided from the borrower's own funds;

(2) The borrower requests the withdrawal after the second year of housing project operations and prior to the 7th year of operations;

(3) The housing project has had a 90 percent occupancy rate for a period of 12 months prior to the withdrawal request;

(4) The withdrawal will not affect the financial viability of the housing project;

(5) Contributions to the reserve account are at authorized levels;

(6) The withdrawal request will not result in rent increases; and

(7) There are no outstanding deficiencies in management's physical maintenance of the housing project.

#### § 3560.305 Return on investment.

(a) *Borrower's return on investment.* Borrowers may receive a return on their investment (ROI) in accordance with the terms of their loan agreement and the following:

(1) If there is a positive net cash flow in housing project operations, the ROI may be taken by the borrower after the housing project's fiscal year, provided that the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that an ROI should not have been taken, borrowers will be required to return any unauthorized ROI.

(2) If there is negative cash flow in housing project operations, the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the housing project's annual financial reports and determines:

(i) Surplus cash exists in either the general operating account as defined in § 3560.306(d)(1) or the reserve account, if the balance is greater than the required deposits minus authorized withdrawals.

(ii) The housing project has sufficient funds to address identified capital or operational needs.

(b) *Unpaid return on investment.* An earned, but unpaid ROI for the previous year only may be requested by the borrower and authorized by the Agency under the provisions of § 3560.305(a)(2) provided the current year's ROI has been paid first and a rent increase is not required to generate funds to pay the unpaid ROI.

#### § 3560.306 Reserve account.

(a) *Purpose.* To meet the major capital expense needs of a housing project, borrowers must establish and maintain a reserve account.

(b) *Financial management of the reserve account.* Borrower management of the reserve account is subject to the requirements of 7 CFR part 1902, subpart A regarding supervised bank accounts.

(c) *Funding of the reserve account.* Borrowers must make payments to the reserve account in the amount established in loan documents, beginning with the first loan payment or a date specified in loan documents.

(d) *Transfer of surplus general operating account funds.* (1) The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, include the amount that

should be escrowed by year end and subtract such tax and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

(2) If a housing project's general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year. At the end of the borrower's fiscal year, if the borrower is required to transfer surplus funds from the general operating account to the reserve account, the transfer does not change the future required contributions to the reserve account.

(e) *Account requirements.* Borrowers must establish and maintain the reserve account according to § 3560.65, § 3560.302(c)(5), and the following requirements:

(1) Reserve accounts must be deposited in interest-bearing accounts or securities; and

(2) Reserve accounts must be supervised accounts that require Agency countersignatures on all withdrawals.

(f) *Funds invested in securities.* In addition to the requirements specified in paragraph (e) of this section, the following requirements apply when reserve funds are invested in securities:

(1) The reserve account must be held either at a Federally insured domestic institution such as a bank, savings and loan association, credit union, or at a domestic institution authorized to sell securities.

(2) The borrower must record the price actually paid for the securities. When designated as a reserve deposit, the price paid must equal the required contribution to reserves.

(3) Borrowers must be knowledgeable about industry practices and consider the impact of typical fees and charges for purchases and sales and maintenance of an account when making investment decisions. Such fees may be paid for out of reserves, only with the consent of the Agency. Housing project funds may not be used to pay for a financial advisor.

(g) *Use of the reserve account.* (1) Borrowers must request Agency approval of reserve account withdrawals prior to the withdrawal. Borrowers must inform the Agency of planned uses of reserve accounts in their annual capital budget if known at budget planning time. Any item on the approved capital budget does not require additional pre-approval by the Agency.

(2) The Agency will indicate any conditions governing withdrawals from a reserve account at the time it approves the withdrawal.

(3) In emergency situations, the Agency may specify special procedures to provide an expedited approval process for the use of the reserve account.

(4) The Agency may approve the use of reserve funds for operating costs when circumstances that are determined by the Agency to be beyond the borrower's control have resulted in a shortfall in the housing project's general operating account.

(h) *Allowable uses.* Allowable uses of reserve funds include the following:

(1) Major capital improvements and replacements.

(2) Housing project operating expenses provided the requirement of paragraph (g)(4) of this section has been met, including:

(i) Payments due on the loan, or

(ii) Payment of a return on investment at the end of the borrower's fiscal year if such payment comes from surplus operating funds in the reserve account.

(3) With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year.

(4) For other purposes, which in the judgment of the Agency will promote the loan purposes, strengthen the security or facilitate, improve, or maintain the housing and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security.

(i) *Records.* Borrowers must maintain records documenting all expenses that were paid by withdrawals from the reserve account.

(j) *Changes to reserve requirements.*

(1) As projects age, the required reserve account level may be adjusted to meet anticipated "life-cycle" needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

(2) The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

(k) *Excess reserves.* Amounts in the reserve account which exceed the total

required by the loan or grant agreement must be used, at the direction of the Agency, for any of the following:

(1) Pay for expenses specified in a long-term capital plan;

(2) Make payments and reamortize the Agency loan;

(3) Reduce rents by a transfer to the general operating account;

(4) Fund preservation incentives authorized in subpart N of this part; or

(5) Cover other expenditures determined to be related to the purpose of the housing project and in the best interest of the Federal Government.

(l) *Procurement.* The requirements of § 3560.102(g), (j), and (k), and all other Agency requirements relating to procurement, bidding, identity-of-interest, cost-reasonableness, and construction management apply to any work or services paid out of reserve funds. Structural repairs and other significant work on major building systems such as heating or air conditioning must be done in accordance with the requirements of 7 CFR part 1924, subpart A.

#### § 3560.307 Reports.

(a) *Required reports.* Borrowers must submit required reports using Agency-approved formats.

(b) *Quarterly and monthly reports.* The Agency may require quarterly or monthly reports to monitor financial progress when closer supervision is warranted.

#### § 3560.308 Annual financial reports.

(a) *General.* Borrowers must submit annual financial reports that meet the requirements of this section. The annual financial reports to be submitted are the Multi-Family Housing (MFH) Project Budget with actual expenditures and the MFH Balance Sheet. Annual financial reports are due to the Agency within 90 days of the end of the borrower's fiscal year.

(1) Borrowers with 16 or more units in their housing project must base their annual financial reports on an engagement report completed according to agreed upon procedures established by the Agency as specified in paragraph (b) of this section. Borrowers must include the engagement report with their annual financial reports submitted to the Agency.

(2) Borrowers with less than 16 units in their housing project must submit annual financial reports using a limited scope engagement based on Agency approved procedures and certify that the housing meets the performance standards established in paragraph (c) of this section. Borrowers may use a CPA to prepare this report. For properties

that prepare a limited scope engagement, the Agency may undertake random audits, once every two or three years.

(3) If a third party requires it, the borrower may have a CPA prepare an audit in accordance with generally accepted government auditing standards (GAGAS). Costs incurred to obtain this audit are an allowable project expense.

(b) *Engagement requirements.* Borrowers required to submit annual financial reports based on an engagement performed by a CPA must meet the following requirements:

(1) Borrowers must use an Agency approved engagement letter. Borrowers must submit the results of an engagement that examines specific records using agreed upon procedures established by the Agency and that describes the borrower's performance in meeting the standards described in paragraph (c) of this section.

(2) The engagement will be initiated by the borrower using the Agency's engagement letter, which will specify the engagement program and establish the reporting requirements for the engagement.

(3) The engagement must be conducted by a CPA in accordance with American Institute of Certified Public Accountant (AICPA) Standards and Agency requirements.

(4) All engagement reports must be prepared for use by the Agency.

(c) *Performance standards.* Borrowers must ensure that:

(1) Required accounts are properly maintained and tracked separately;

(2) Payments from operating accounts are disclosed and accurately represented on financial reports;

(3) The reserve amount is at the authorized level and there are no encumbrances;

(4) Tenant security deposit accounts are fully-funded and are maintained in separate accounts and meet state and local requirements;

(5) Amount of payment of owner return was consistent with the terms of the applicable loan agreement;

(6) The borrower has maintained proper insurance in accordance with the requirements of § 3560.105(b); and

(7) All financial records are adequate and suitable for examination.

(d) *Other financial reports.* (1) Nonprofit and public borrower entities must submit audits in accordance with 7 CFR part 3052 that must also include the requirements set forth in the limited scope engagement.

(2) The Agency may require additional opinions of financial condition and compliance, such as audits, to assure the security of the

asset, determine whether the housing project is being operated at a reasonable cost, or to detect fraud, waste, or abuse.

(3) Any audits independently obtained by the borrower also must be submitted to the Agency.

**§ 3560.309 Advancement (loan) of funds to a RRH project by the owner, member of the organization, or agent of the owner.**

(a) Prior written approval by the Servicing Office is required. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short-term in nature, a servicing plan may be developed and advances may be approved in accordance with the provisions set out in § 3560.453 of this part. Justification will be based on the following:

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

(2) Funds are not immediately available from any of the following sources:

- (i) Reserve funds;
- (ii) Initial operating capital; and
- (iii) An imminent rent increase.

(b) The funds will be applied to ordinary project operating and maintenance expenses.

(c) Interest may be charged or paid on the loan from project income; however, interest must be reasonable. The proposal may be denied if Rural Development financing can be provided to resolve the problem in a more cost-effective manner.

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

(e) The payback of the advance (loan) may be permitted by the Servicing Official provided the terms and conditions were mutually agreed to by the borrower and Rural Development at the time of the advance and the financial position of the project will not be jeopardized. Payback should only be permitted on the advance when the Rural Development debt is current and the reserve requirements are being maintained at the authorized levels.

**§§ 3560.310–3560.349 [Reserved]**

**§ 3560.350 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget

(OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart H—Agency Monitoring**

**§ 3560.351 General.**

This subpart contains policies for Agency monitoring of operations and management at multi-family housing (MFH) projects.

**§ 3560.352 Agency monitoring scope, purpose, and borrower responsibilities.**

(a) *Scope of Agency monitoring activities.* The Agency will review reports, records, and other materials related to the housing project, including borrower financial reports, housing project records, and other communications. The Agency also will review material related to a housing project submitted by a tenant or other source. To assess conditions such as a housing project's physical condition, record keeping procedures, and operations and management activities, including borrower compliance with Federal, state, and local laws and Agency requirements, the Agency will conduct periodic on-site monitoring reviews of a housing project.

(b) *Purpose of Agency monitoring activities.* Agency monitoring activities are designed to assess borrower and tenant compliance with Agency requirements, and to:

(1) Ensure housing projects are managed in accordance with the goals and objectives of the Agency's MFH programs and are maintained in accordance with Agency requirements for affordable, decent, safe, and sanitary housing;

(2) Preserve the value of the Agency-financed housing projects;

(3) Detect waste, fraud, and abuse in housing project operations or management and to ensure the cost of operations and management are necessary and reasonable;

(4) Verify compliance with Affirmative Fair Housing Marketing requirements, Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended, section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans

with Disabilities Act of 1990, other applicable Federal laws, and Agency requirements related to occupancy and tenant eligibility.

(c) *Borrower responsibilities.* The borrower is responsible for cooperating fully and promptly with Agency monitoring activities. Agency monitoring activities do not diminish borrower operation and management responsibilities and do not relieve borrowers from any Agency requirements including, but not limited to, borrower requirements to comply with:

(1) The terms of all agreements with the Agency, including the loan or grant agreement, assurance agreement, loan resolution, promissory note, mortgage, interest credit agreement, rental assistance agreement, mitigation measures contained in the environmental review document, and workout agreement;

(2) The requirements contained in this part;

(3) The requirements of Title VI of the Civil Rights Act of 1964, Title VIII of the Civil Rights Act of 1968, as amended; section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, Americans with Disabilities Act of 1990; and

(4) Applicable Federal, state, and local laws.

**§ 3560.353 Scheduling of on-site monitoring reviews.**

Generally, the Agency will provide the borrower prior notice of an on-site monitoring review and will conduct the on-site monitoring review in the presence of the borrower. However, the Agency may visit a housing project, without prior notice, to observe physical conditions, operations and management activities, or other borrower or tenant activities. In addition, the Agency may conduct on-site reviews without the presence of the borrower, the management agent, or other designated representative of the borrower.

**§ 3560.354 Borrower response to monitoring review notifications.**

The Agency will notify borrowers, in writing, whenever Agency monitoring activities result in deficiency findings or compliance violations. The monitoring review notification will describe the deficiencies findings or compliance violations and will specify a time period by which corrective action must be taken by the borrower. The notification will offer borrowers an opportunity to discuss the reported deficiency findings or compliance violations with the Agency and will explain enforcement actions that the Agency may take if

corrective action is not taken within the time period specified in the monitoring review notification. When civil rights non-compliance is found, the State Civil Rights Coordinator or Manager (SCRC/M) will be notified. If voluntary compliance cannot be obtained, appropriate enforcement or remedial action will be taken.

**§§ 3560.355–3560.399 [Reserved]**

**§ 3560.400 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart I—Servicing**

**3560.401 General.**

(a) *Purpose.* This subpart contains actions the Agency may take to service and collect loans or other debts owed by multi-family housing (MFH) borrowers. The loan servicing and other actions set forth are designed to protect Agency and tenant interests and assist borrowers in meeting program objectives.

(b) *General servicing policies.* Borrowers must repay loans or other amounts due to the Agency according to provisions specified in promissory notes, loan agreements and resolutions, mortgages, deeds-of-trust, assumption agreements, reamortization agreements, or other agreements executed between the borrower and the Agency.

(c) *Special servicing actions.* The Agency will not agree to any proposal for loan servicing or debt collection action other than actions consistent with this section, debt instruments, and other agreements. When payments due to the Agency from a borrower remain unpaid for more than 30 days after the due date, past due, after the Agency may initiate the special servicing actions described in subpart J of this part.

**§ 3560.402 Loan payment processing.**

(a) *Predetermined Amortization Schedule System (PASS) requirements.* All loans, except the loans specified in paragraph (c) of this section, must be closed and serviced using the PASS.

(b) *Required conversion to PASS.* Borrowers with Daily Interest Accrual System (DIAS) accounts must convert to PASS whenever a loan servicing action on the account involves a change in the loan rates or terms or whenever a subsequent loan to the borrower is closed.

(c) *Exceptions.* Seasonal farm labor housing loans and on-farm labor housing loans may be closed on DIAS, monthly, or annual payment schedules.

**§ 3560.403 Account servicing.**

(a) *Payment due dates.* Loan or other payments due to the Agency are due on the first day of each month unless otherwise established in the debt instrument or other agreement executed with the Agency.

(b) *Payment application order.* Loan payments will be applied to the borrower's account in the following order of priority:

(1) Amortized audit receivables. (*i.e.*, amounts due to the Agency, over a period of time, as a result of a finding from an audit or other monitoring activity.)

(2) Unamortized audit receivables. (*i.e.*, amounts due to the Agency, in a lump sum payment, as a result of a finding from an audit or other monitoring activity.)

(3) Late fees. (*i.e.*, amounts due to the Agency as a result of late payments.)

(4) Amortized recoverable costs. (*i.e.*, amounts due to the Agency, over a period of time, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(5) Unamortized recoverable costs. (*i.e.*, amounts due to the Agency, in a lump sum payment, as a result of Agency payments made on behalf of a borrower for housing project related expenses such as taxes or insurance premiums.)

(6) Overage. (*i.e.*, amounts due to the Agency as a result of a tenant's tenant contribution being higher than basic rent.)

(7) Interest. (*i.e.*, amounts due to the Agency as a result of scheduled interest on a loan and as a result of interest charged on unpaid delinquent principal amounts.)

(8) Principal. (*i.e.*, amounts due to the Agency as the loan principal.)

(9) Advance payments. (Any funds remaining after disbursement of a payment to all other payment priorities will be applied to the borrower's account as an advance regular payment unless a borrower specifically designates, in writing, another application.)

(c) *Late fees.* If payments on a borrower's account, under PASS, are

more than \$15 delinquent after the close of business on the 10th day after the payment due date, a late fee will be charged to the borrower's account.

(1) Late fees charged to a borrower's account will equal 6 percent of the total regular payments due as specified in any promissory notes, assumption agreements, or reamortization agreements related to the borrower's account.

(2) Late fees are a borrower expense and must not be paid from housing project funds.

(3) The Agency may waive late fees for circumstances beyond a borrower's control and when a waiver is determined by the Agency to be in the best financial interest of the Federal Government.

(d) *Interest on unpaid overdue principal.* On the first day of the month following a payment due date, the Agency will charge interest at the note rate on any unpaid principal payment due according to the loan's amortization schedule (*i.e.*, interest will be charged on delinquent principal). The interest charged on the unpaid principal payment due will be charged to the borrower in addition to the scheduled interest due on payments according to the loan's amortization schedule.

#### **§ 3560.404 Final loan payments.**

(a) *Payoff statements.* At the borrower's request, the Agency will provide a statement indicating the payoff amount necessary to pay the borrower's account in full.

(b) *Final payments.* A borrower's final loan payment must include repayment of all outstanding obligations to the Agency.

(1) Any supervised funds being held by the Agency will be applied to the borrower's account or, at the borrower's option, will be returned to the borrower following acceptance of final payment on all outstanding obligations.

(2) If a balance due remains on a borrower's account after Agency acceptance of a final payment, due to borrower error or fraud or Agency error, the Agency will initiate collection action in accordance with the unauthorized assistance collection procedures described in subpart O of this part.

(c) *Final payment loans.* Borrowers with loans for which the Agency approved an amortization period that exceeded the term of the loan may request a loan to finance the final payment in accordance with the requirements of § 3560.74.

(d) *Loan prepayment requests.* If prepayment of an Agency loan is requested, the applicable preservation

requirements of subpart N of this part, including the execution of any appropriate restrictive-use agreements, must be met prior to the Agency's acceptance of a final loan payment under the prepayment request.

(e) *Payment forms.* Final payments may be made by cashier's check, certified check, money order, bank draft, or other withdrawal instruments approved by the Agency.

(1) If borrowers use forms of payment requiring special handling, the borrower is responsible for the cost of the special handling.

(2) When payment is provided in a form that is not the equivalent of cash, the Agency will consider the payment to be received at the time the payment has been converted to cash and funds have been transferred to the Agency.

(f) *Release of security instruments.* The Agency will release security instruments, subject to applicable restrictive-use agreements referenced in subpart N of this part, when full payment of all outstanding obligations to the Agency has been received, accepted, and the funds have been transferred to the Agency.

(1) If the Agency and the borrower agree to settle an account for less than the full amount owed, the Agency will release security instruments when the borrower has paid in full all agreed upon obligations.

(2) Recording costs for the release of the security instruments will be the responsibility of the borrower, except where state law requires the mortgagee to record or file the satisfaction.

(g) *Special circumstances—Refund of entire principal.* If the entire principal of the loan is refunded after the loan is closed, the borrower must pay interest from the date of the note to the date of receipt of the refund.

#### **§ 3560.405 Borrower organizational structure or ownership interest changes.**

(a) *General.* The requirements of this section apply to changes in a borrower entity's organizational structure or to a change in a borrower entity's controlling interest. If 100 percent of a borrower entity's ownership interest is transferred, within a 12-month period, the change will be considered a housing project transfer and the provisions of § 3560.406, which covers transfers or sales of housing projects, will apply.

(b) *Agency requirements.* Borrowers must notify the Agency prior to the implementation of any changes in a borrower entity's organizational structure. The Agency must give its consent prior to the implementation of changes in a borrower entity's controlling interest.

(1) Borrowers must submit written requests for Agency consent to the Agency at least 45 days prior to the anticipated effective date of the proposed organizational change. The request must document that the proposed changes will not adversely affect the program purposes or security interest of the Agency and will not adversely affect tenants.

(2) If the controlling interest change involves a transfer of interest to an entity not previously holding an ownership interest in the borrower entity, the request for consent must include a written certification, executed by the party receiving the ownership interest, certifying that the recipient of the ownership interest agrees to assume responsibilities and obligations required of a borrower as established in Agency program requirements including requirements in the promissory note, loan agreement, or other document related to Agency loans held by the borrower entity.

(3) The Agency will not take a consent request for a controlling interest change under consideration if the borrower's request fails to meet the requirements specified in paragraph (b)(2) of this section.

(c) *Documentation of organizational structures and ownership interest.* Borrowers must annually document their organizational structure and ownership.

(1) Documentation must be submitted with the annual financial reports required by § 3560.308 and must reflect any changes made during the 12-month period preceding the submission of the annual financial reports.

(2) If no changes in a borrower entity's organizational structure or ownership were made during the 12-month period prior to submission of the annual financial reports, borrowers are not required to submit documentation, but must submit a statement certifying that no changes have been made in the documents on file with the Agency.

(3) Organizational structure and ownership documentation must include the following items:

(i) A current organization description reflecting all approved changes in the organizational structure of the borrower entity and listing the names, addresses, and tax identification numbers of all parties with an ownership interest in the borrower entity; and

(ii) A written statement by the borrower certifying that the changes in the borrower entity's organizational structure or ownership interests were completed in compliance with state and local laws and in accordance with

organizational requirements of the borrower entity.

**§ 3560.406 MFH ownership transfers or sales.**

(a) *General.* The provisions of this section apply to ownership transfers or sales (e.g., title transfers) involving an Agency financed housing project. The provisions cover situations where Agency loans are being assumed as a part of a housing project transfer or sale.

(b) *Agency consent requirements.* Agency consent must be obtained prior to an ownership transfer or sale and Agency consent will only be given when the transfer or sale is in the best interest of the Federal Government. Any ownership transfer or sale without the consent of the Agency will be considered a default and will be handled in accordance with subpart J of this part.

(1) Priority consideration will be given to ownership transfers or sales needed to remove a hardship to the borrower that was caused by circumstances beyond the borrower's control.

(2) Ownership transfers or sales with an assumption of debt at an amount less than the borrower's debt amount will only be approved by the Agency when all persons in the borrower entity who are transferring their ownership interest or are involved in the selling of the property are not part of the transferee organization.

(c) *Consent request requirements.* Borrowers must submit written requests for Agency consent to an ownership transfer or sale of a housing project to the Agency at least 45 days prior to proposed ownership transfer or sale date. The consent request must document that the proposed transfer or sale meets the requirements of paragraph (d) of this section and must include the following items:

(1) A statement disclosing any identity-of-interest between the borrower and the party to which the housing project ownership is being transferred or sold.

(2) A statement certifying that the housing project's financial accounts are funded at required levels, less authorized withdrawals, and that payments due for operation and maintenance expenses, tax assessments, insurance premiums, any required tenant security deposit accounts, and other obligations incurred as a part of the housing project operations are paid in full with no overdue balances or a statement explaining the housing project's financial situation and the reasons for overdue payments or under funded accounts.

(3) A proposed housing project budget covering the partial year, if applicable, and first full year operation following the ownership transfer or housing project sale.

(4) A written statement, signed by the proposed transferee or buyer, certifying that the transferee or buyer will assume the borrower responsibilities and obligations specified in Agency program requirements including requirements in a promissory note, loan agreement or other documents related to Agency loans held by the borrower entity.

(5) A certification from the borrower and the proposed transferee or buyer that the borrower does not and will not have a reversionary interest in the housing project.

(d) *Requirements for ownership transfers or sales.* An ownership transfer or sale of a housing project with an assumption of Agency loans by the transferee or buyer must comply with the following conditions:

(1) The transferee or buyer must be an eligible borrower under the requirements established by subpart B of this part;

(2) The transferee or buyer must agree to set basic rents at the housing project covered by the assumed loans at levels that do not exceed conventional rents for comparable units in the area, except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150% of the comparable rent for conventional unit rent level; and

(3) The value of the housing project covered by the loans to be assumed, at the time of an ownership transfer or sale, must be sufficient to ensure that all Agency loans being assumed and all subsequent loans being offered as a part of the transfer or sale can be secured to a level that fully protects the Agency's interest. Loans from third-party sources that are not dependent on project revenue for payment will not be included in this determination.

(i) If the total value of the loans being offered as a part of an ownership transfer or sale is \$100,000 or less, the security value of the housing project may be determined through either: An Agency review of monitoring reports conducted in accordance with the requirements in subpart H of this part or an appraisal paid for by the borrower and conducted in accordance with subpart P of this part.

(ii) If the total value of the loans being offered as a part of an ownership transfer or sale exceeds \$100,000, the security value of the housing project must be determined through an appraisal obtained by the Agency and conducted in accordance with subpart P of this part.

(iii) The Agency may approve a loan write-down, in accordance with § 3560.455, prior to an ownership transfer or sale to reduce the amount of debt being assumed by the transferee or buyer.

(4) Prior to Agency approval of an ownership transfer or sale, an environmental review, as required under the National Environmental Policy Act and in accordance with 7 CFR part 1940, subpart G, must be conducted on all property related to the ownership transfer or sale. If contamination from hazardous substances or petroleum products is found on the property, the finding must be disclosed to the Agency and the transferee or buyer and must be taken into consideration in the determination of the housing project's value.

(5) All immediate and long-term repair and rehabilitation needs must be identified by a capital needs assessment. The reserve requirements for the housing project will be reviewed by the Agency and adjusted, if necessary, to adequately cover the cost of addressing the property's capital needs. The Agency may approve the release of the current reserve amount to the transferor provided the transferee agrees to deposit the amount to cover the project's immediate needs into the reserve account at closing.

(6) The borrower and transferee must disclose to the Agency all terms, conditions, or other considerations related to the ownership transfer or sale. All side or other agreements must be disclosed and all sources and uses of funds related to the ownership transfer or sale must be disclosed.

(7) An agreement must be signed between the borrower and the transferee listing all repairs known by the borrower to be necessary to bring the housing project into compliance with Agency requirements for decent, safe, and sanitary housing as listed in subpart C of this part.

(i) The agreement must include repairs required to correct compliance violations cited in a compliance violation notice issued by the Agency.

(ii) The agreement must specify whether each repair listed will be completed by the borrower prior to the ownership transfer or by the transferee in accordance with a workout agreement developed in accordance with the

requirements of § 3560.453 and executed between the transferee or buyer and the Agency.

(8) A civil rights compliance review, as required by 7 CFR part 1901, subpart E, will be conducted by the Agency prior to the ownership transfer or sale.

(9) During or immediately after the transfer, a review of the property must be conducted to ensure that it complies with or will comply with section 504(c) of the Americans with Disabilities Act (ADA), which covers accessibility requirements, and the Title VI of the Fair Housing Act of 1968.

(10) A transferee must ensure that tenant certifications in compliance with subpart D of this part for all occupied rental units are on file with the Agency.

(11) A transferee must comply with insurance and bonding requirements established in subpart C of this part at the time of the transfer.

(12) A transferee must agree to submit financial reports to the Agency according to subpart G of this part.

(13) A transferee must establish that there are no liens, judgments, or other claims against the housing project other than those by the Agency and those to which the Agency has previously agreed.

(14) A limited profit Rural Rental Housing transferee's initial investment and return on investment will remain the same as that originally provided to the transferor unless:

(i) The property is transferred to a non-profit entity and the return on investment is eliminated; or

(ii) The transferee contributes additional funds for repair or rehabilitation and the Agency agrees to recognize a higher initial investment.

(e) *Equity payments.* The Agency will withhold any equity payment due to the borrower, as part of an ownership transfer or sale, if any of the following conditions exist:

(1) The borrower's indebtedness to the Agency has not been paid in full or is not being assumed by the transferee. The Agency will require that all or part of an equity payment be applied against other Agency loans owed by the borrower if payments on the other loans are not current.

(2) Any non-Agency prior liens against a housing project are not paid in full.

(3) Any housing project financial accounts are not funded at required levels, less authorized withdrawals, or any payments due for operation and maintenance expenses, tax assessments, insurance premiums, tenant security deposits or other obligations incurred as a part of housing project operations are not paid in full.

(4) Any management deficiencies cited in a compliance violation notice issued by the Agency to the borrower have not been corrected or the housing project is not operating under an approved management plan or, if applicable, an approved management agreement.

(5) Any operation and maintenance deficiencies cited in compliance violation notices issued by the Agency have not been corrected or are not scheduled for correction in a workout agreement developed in accordance with the requirements of § 3560.453.

(6) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or other Federal, state, or local agencies for violations of Fair Housing or Equal Opportunity requirements.

(7) The borrower entity is, at the time of the ownership transfer or sale, cited by the Agency or any other entity involved in the financing of the housing project for misappropriation of funds.

(f) *Equity payment funding sources.* Equity may be provided in cash or through a loan. If a full equity payment to the transferor is not paid at the time of the ownership transfer or sale or has not been paid through an Agency equity loan or third-party equity loan approved by the Agency to the borrower, the transferee must certify that equity payments due to the borrower will be paid from sources other than housing project's funds and must identify the sources of such payments.

(g) *Restrictive-use requirement.* Transferees assuming Agency loans, including loans approved prior to December 21, 1979, will be required to execute a restrictive-use agreement that contains the language specified in § 3560.662. The restrictive-use agreement will require the housing project to be used for program purposes for a specified period of time beyond the date that the ownership transfer or sale is closed. When an equity loan is involved at the time of transfer, the restrictions will be for 30 years.

(h) *Subsequent loans.* The Agency may approve a subsequent loan or permit a loan from a third-party source in conjunction with an ownership transfer or sale of a housing project. The subsequent loan may be in the form of a junior or parity lien.

(1) Subsequent loans on a housing project proposed in conjunction with an ownership transfer or sale must be requested and processed in accordance with the Agency loan origination requirements in subpart B of this part.

(2) The Agency may amortize the subsequent loan over a period not to exceed the remaining economic life of

the housing or 50 years, whichever is less.

(3) The Agency may extend the term of the existing loan to a period not to exceed 30 years or the remaining economic life of the housing, whichever is less.

(i) *Loan assumption interest rates.*

The interest rate for Agency loans assumed in conjunction with an ownership transfer or sale will be determined as follows:

(1) The interest rate for all loans, except farm labor housing loans, will be set at the lower of:

(i) The note rate of the existing Agency loan;

(ii) The Agency note rate on the day the transfer is approved;

(iii) The Agency note rate on the day the transfer is closed; or

(iv) If the rents are increased due to a transfer, the transfer will be done under new rates and terms when the Agency determines that it is in the best interest of the government. Subsequent loan may be in the form of a senior, junior or parity lien or soft second.

(2) The interest rate on farm labor housing loans will be the rate specified in the note, except that loans transferred to public bodies, nonprofit organizations of farm workers, and broadly-based nonprofit corporations for farm labor housing purposes may be at a one percent interest rate regardless of the rate specified in the note if the Agency determines that such a reduction is necessary to maintain affordable rental rates for tenants.

(j) *Loan assumption terms.* The amount of the loan balance that may be assumed through an ownership transfer or sale must not exceed the security value of the housing project determined according to § 3560.406(d)(3)(i).

(1) The Agency may reamortize a loan assumed through an ownership transfer or sale over a period not to exceed the remaining economic life of the housing or 50 years, whichever is less.

(2) The Agency may extend the term of the loan to a period not to exceed 30 years or the remaining economic life of the housing, whichever is less.

(3) When loans assumed through an ownership transfer or sale are amortized on an annual payment basis, the loans will be converted, at the time of the transfer or sale, to a monthly payment amortization and will be made subject to PASS. When on- or off-farm labor housing projects are involved in an ownership transfer or sale, the related loans may be transferred on a DIAS basis or converted to PASS if the Agency determines that such a conversion will not be detrimental to the operation of the farm labor housing.

(k) *Processing ownership transfers or sales.* (1) At the time of the transfer, the Agency will require the borrower to transfer all equipment, related facilities, and housing project financial accounts to the transferee including the operation and maintenance account, reserve account, tenant security deposit account, tax and insurance escrow accounts.

(i) Any funds remaining in a rental assistance contract not dispersed by the transferor will be assigned to the transferee unless the rental assistance is not needed for tenants or another form of rental subsidy is to be used.

(ii) Any rental assistance determined to be unnecessary will be reassigned to other housing projects in accordance with the provisions of subpart F of this part.

(2) The Agency will require that appropriate loan documents are executed by the transferee. The Agency may require such documents to be referenced in security instruments (e.g., mortgage or deed of trust).

(3) If all of a borrower's outstanding Agency debt is not assumed or paid off at the time of the transfer or sale, the Agency will not release a borrower from liability unless the Agency determines that the borrower is unable to pay the remaining debt from assets taken as security through the debt settlement procedure in accordance with § 3560.457.

(l) *Ownership transfers or sales under special rates, terms, and conditions.* Housing projects may be transferred or sold to entities that do not meet borrower eligibility requirements for the type of loans being assumed. However, such a transfer or sale will only be considered when it is determined by the Agency to be in the best interest of the Federal Government and the objectives of the original loan can no longer be met. The following special rates, terms, and conditions will apply to such situations.

(1) The transferee makes a down payment of at least 10 percent of the remaining loan balance to be assumed.

(2) The transferee has the ability to pay the Agency debt.

(3) Monthly or annual installments will be amortized over the term of the loan and the interest rate will be at a rate of interest at least one percent higher than the interest rate offered to eligible borrowers as specified in paragraphs (i)(1) or (2) of this section.

**§ 3560.407 Sales or other disposition of security property.**

(a) *General.* Borrowers must obtain Agency approval prior to selling or exchanging all or a part of, or an interest

in, property serving as security for Agency loans. Agency approval also must be requested and received prior to the granting or conveyance of rights-of-way through property serving as security property. An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency approves all such sales or other dispositions of security property.

(b) *Request requirements.* Requests for Agency approval of transactions related to security property must document that the following conditions will be met.

(1) The borrower's ability to repay the Agency debt will not be impaired;

(2) The transaction will not interfere with the successful operation of the housing project or prevent the borrower from carrying out the purpose for which the loan was made.

(3) The monetary or other consideration offered in the transaction is equal to or greater than the market value of the security property being disposed of or the rights being granted, except that right-of-way easements may be granted or conveyed with minimal or no consideration being offered if:

(i) The value of the security property will not be reduced;

(ii) The suitability of the security property for the intended purpose will not be impaired; and

(iii) The easement is granted to allow the borrower to develop additional lots or units that will be integrated into the housing project or for enhancement of streets, utilities or other services provided by a public body.

(4) The property that will remain as security for Agency loans, after any transaction related to security property, will fully secure the borrower's debt to the Agency.

(5) Borrowers must report to the Agency the total of all proceeds derived from the sale or other disposition of property serving as security for Agency loans. The proceeds from the disposition of the security property will be used for purposes approved by the Agency.

**§ 3560.408 Lease of security property.**

(a) *General.* Borrowers must obtain Agency approval prior to entering into a lease agreement related to any property serving as security for Agency loans. An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency can give lease approval for real property serving as security for Agency loans.

(b) *Leases to public housing authorities.* Borrowers may not lease all or part of their housing facilities to a housing authority. Lease agreements in

place prior to the effective date of this regulation may be continued provided that leases are in a form acceptable to the housing authority and are on terms that will enable the borrower to comply with Agency program requirements, to meet Agency program objectives, and make loan and other required payments to the Agency on an Agency approved schedule.

(c) *Lease of a portion of the security property.* The Agency may, subject to the applicable provisions governing loan purposes found in of § 3560.53, § 3560.553 and § 3560.603, approve the leasing of facilities related to a housing project (e.g., central kitchens, recreation facilities, laundry rooms, and community rooms) when the borrower will continue to operate the facilities for the purposes for which the loan was made. Agency approval is not required for leases with a term of less than 30 days. The Agency will only approve a lease with a term over 30 days if the following conditions are met:

(1) The lease is in the best interest of the borrower, the tenants, and the Federal Government.

(2) The amount of the consideration agreed to in the lease is adequate to pay all prorated operating and maintenance expenses, a prorated share of the annual reserve deposit, and the prorated part of the loan amortization at the note rate of interest.

(3) All compensation and considerations, whether payments, a share of proceeds, or improvements to the property paid for by the lessee, must be disclosed to the Agency. No payments or compensation for entering into a lease shall flow to the borrower or any identity-of-interest related to the borrower.

(4) The lease provides at its termination for the restoration of the leased space to its original condition or a condition acceptable to the owner and the Federal Government.

(5) Consent to the lease will not exceed 3 years at a time unless the Agency determines that a longer lease is advantageous to the borrower, the tenants, and the Federal Government.

(6) When another lienholder's mortgage requires that lienholder's consent to a lease, the borrower must obtain written consent from the lienholder before the Agency will consider approving the lease.

(d) *Mineral leases.* Mineral leases will be handled according to 7 CFR 3550.159 except that all references to County Supervisor will be construed to mean District Director when applied to the MFH Programs.

**§ 3560.409 Subordinations or junior liens against security property.**

(a) *General.* Borrowers must obtain Agency consent prior to entering into any financial transaction that will require a subordination of the Agency security interest in the property (i.e., granting of a prior interest to another lender.) An environmental review must be completed in accordance with 7 CFR part 1940, subpart G, before the Agency can consent to a subordination or junior lien against the property. Borrowers must use an Agency approved subordination agreement.

(1) If a lien is placed against property serving as security for an Agency loan without prior Agency consent, the Agency will declare the borrower to be in default and will pursue liquidation of the borrower's loans in accordance with the procedures specified in § 3560.457, unless an agreement can be reached between the borrower and the Agency to work out removal of the lien or post approve the lien.

(2) Subordinations or junior liens need not encompass the entire site, (e.g., a subordination or junior lien requested to permit an interim lender to advance construction funds may only cover the portion of the site proposed for construction.)

(3) The subordination or junior lien must be for a specific amount.

(4) The subordination or junior lien must not adversely impact the Agency's ability to service the loan according to the requirements of this part.

(b) *Consent request requirements.* Borrowers proposing to have the Agency subordinate its interest to another lender or to give a creditor a junior lien against property serving as security for an Agency loan must submit a consent request to the Agency. The consent request must document the following:

(1) The action will enable the borrower to obtain financial resources for improvements or repairs on the security property that are consistent with the purposes of the Agency loan secured by the property.

(2) The action will not adversely impact the borrower's financial condition and the borrower's ability to repay the Agency loan being secured by the property.

(3) The action will not result in basic rents at the security property that exceed conventional rents for comparable units in the area.

(4) The terms and conditions of the credit to be secured by the subordination or junior lien are not expected to adversely affect the borrowers ability to meet the terms and conditions of the Agency loan secured by the property.

(5) The proposed use of the funds obtained through the granting of a subordination or junior lien will not adversely affect the borrower's ability to meet Agency program requirements or to operate and manage the housing project in a manner consistent with program objectives.

(6) The creditor receiving the "subordination" of interest in the property or the junior lien will agree that a foreclosure or acceptance of a deed-in-lieu of foreclosure will not be initiated without at least 30 days prior notice to the Agency.

(7) The subordination or junior lien is not being secured with any funding from housing project financial accounts.

(8) The "subordination" of interest or junior lien will not cause the debt from all sources to exceed the value of the security property.

(9) The transaction related to the placement of a "subordination" of interest or junior lien against the property serving as security for an Agency loan is in the best interest of the Federal Government.

(c) *Required conditions for subordinations and junior liens.* Subordinations of interest in or junior liens against property serving as security for an Agency loan may be approved by the Agency only if they improve a borrower's financial condition and allow for improvements or repairs that are consistent with the purposes of the Agency loan secured by the property.

(1) Farm Labor Housing loans on farm tracts may be subordinated for essential farm improvements and operations.

(2) Any proposed development must be planned and performed according to 7 CFR part 1924, subpart A, or in a manner directed by the other lienholder that meets the objectives of 7 CFR part 1924, subpart A.

(d) *Other liens against a property or other assets.* (1) Borrowers must not enter into any agreements to place a lien on a housing project or any equipment related to a housing project without prior Agency approval and unless the following conditions are met:

(i) The transaction will not adversely affect the Agency's security position;

(ii) The lien is not related to a non-program eligible action;

(iii) The items to be acquired by the funding related to the lien is needed for the operation of the property; and

(iv) The financing arrangements are otherwise sound.

(2) In cases where the above criteria are met, borrowers must complete and provide the Agency a copy of the financing statement, loan document, or contract, as applicable, as well as a

security agreement acceptable to the Agency.

**§ 3560.410 Consolidations.**

(a) *General.* With Agency approval, loans, loan agreements, or loan resolutions may be consolidated to reduce the administrative burden (i.e., record keeping, budgeting), to improve the cost effectiveness and efficiencies of housing project operations, and to effectively utilize facilities common to housing projects.

(b) *Loan consolidations.* Loan consolidations will only be considered when:

(1) Multiple loans to the one borrower entity are being transferred to a different borrower entity in accordance with § 3560.406, or

(2) One borrower entity has an initial loan and one or more subsequent loans for the same housing project and all the loans were closed on the same date and with the same rates and terms.

(c) *Loan agreement or loan resolution consolidations.* Loan agreements or loan resolutions may be consolidated, even if the loans related to the agreement or resolution are not consolidated, to allow borrowers to comply with reporting, accounting, and other Agency requirements as a single housing project.

(1) The loan agreements or loan resolutions may only be consolidated when they are related to loans made for the same purposes, to the same borrower, and operating under the same type of interest credit, if applicable.

(2) All of a borrower's loan accounts must be current after the loan agreement or loan resolution consolidation is processed, unless otherwise approved by the Agency.

**§§ 3560.411–3560.449 [Reserved]****§ 3560.450 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575-0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

## Subpart J—Special Servicing, Enforcement, Liquidation, and Other Actions

### § 3560.451 General.

This subpart contains special servicing, enforcement, liquidation, and other actions that the borrower may request or the Agency may implement when compliance violations, monetary defaults, or non-monetary defaults cannot be resolved through regular servicing.

(a) *Agency obligations.* The Agency is under no obligation to offer or agree to any special servicing actions.

(b) *Relationship to workout agreements.* Special servicing actions may be implemented either as a part of a workout agreement, developed in accordance with § 3560.453, or as an action approved by the Agency separate from a workout agreement unless indicated otherwise in this subpart.

### § 3560.452 Monetary and non-monetary defaults.

(a) *General.* Borrowers are in default when they have received a compliance violation notice, issued in accordance with § 3560.354, and have failed to correct the compliance violation identified in the compliance violation notice within the time period specified in the notice. Compliance violations include, but are not limited to, violations of promissory note provisions, loan or grant agreement provisions, regulatory, or other Agency requirements, including requirements imposed on a borrower through a workout agreement developed in accordance with § 3560.453.

(b) *Monetary defaults.* A monetary default exists when any amount due to the Agency or a third party (such as real estate taxes and insurance) under a promissory note, loan or grant agreement, workout agreement, or other agreement remains due more than 30 days after the due date.

(c) *Nonmonetary defaults.* A nonmonetary default exists when a borrower fails to correct a compliance violation, other than a monetary amount past due, within the time period specified in a compliance violation notice issued in accordance with § 3560.354. Nonmonetary defaults include, but are not limited to, failure to:

(1) Operate and manage a housing project in accordance with the Agency approved management plan or Agency requirements;

(2) Maintain the physical condition of a housing project in a decent, safe, and sanitary manner and in accordance with Agency requirements;

(3) Keep general operating expense, reserve, and other financial accounts related to a housing project at required funding levels;

(4) Occupy rental units with eligible tenants, unless granted an exception by the Agency;

(5) Charge correct rents or to correctly calculate net tenant contributions, utility allowances, or rental assistance payments or to properly administer the Agency rental assistance assigned to the housing project;

(6) Submit required annual financial reports to the Agency within time periods specified in § 3560.308;

(7) Submit management plans, leases, occupancy rules, and other required materials to the Agency in accordance with Agency requirements; and,

(8) Comply with applicable Federal laws including laws related to civil rights, fair housing, disabilities, and environmental conditions.

(d) *Default notice.* When borrowers are in default, the Agency will notify borrowers, in writing, that they are in default. The default notice will identify the compliance violation that led to the default, will specify actions necessary to cure the default, and will establish a date by which the default must be cured to preclude Agency initiation of enforcement actions, liquidation, or other actions.

(e) *Agency action.* If a borrower fails to cure a default within the time period specified in the default notice, the Agency may initiate the enforcement actions described in § 3560.461 or liquidation as described in § 3560.456. Also, Agency compliance violation notices and related default notices may be referred to Federal, state, and local agencies with jurisdictions related to the violations for handling, in accordance with their requirements.

### § 3560.453 Workout agreements.

(a) *General.* (1) Prevention or resolution of compliance violations or default cures are a borrower's responsibility.

(2) A borrower may develop and submit to the Agency for approval a workout agreement that proposes actions to be taken over a period of time to prevent or correct a compliance violation or to cure a monetary or non-monetary default.

(3) A borrower developed workout agreement may propose, but is not limited to, the following actions:

(i) A combination of one or more of the special servicing actions outlined in §§ 3560.454 and 3560.455;

(ii) A change in operations and management at a housing project; or

(iii) A commitment of additional financial resources to the housing

project with the amount and source of the additional resources to be committed to the housing project specifically identified.

(b) *Workout agreement approval.* (1)

The Agency is under no obligation to approve a workout agreement as submitted by a borrower or to act with forbearance when a housing project is in monetary or non-monetary default.

(2) Borrower developed workout agreements may not be implemented until the borrower receives written approval from the Agency.

(3) The Agency will only approve a workout agreement if the Agency determines that the actions proposed are likely to prevent or correct compliance violations or cure a default and approval is in the best interest of the Federal Government and tenants.

(4) The Agency will only approve a workout agreement if the proposed actions are consistent with the borrower's management plan. If proposed actions are not consistent with the borrower's management plan, applicable revisions to the borrower's management plan must be made before approval of the workout agreement is given.

(c) *Workout agreement required content.* (1) Workout agreements submitted to the Agency for approval must be in writing and signed by the borrower. Workout agreements must describe proposed actions in sufficient detail to demonstrate the likelihood of the actions to prevent or correct compliance violations or cure defaults.

(2) At a minimum, workout agreements must include the following.

(i) The name and address of the housing project, project number, borrower's tax identification number, and other information necessary to identify the housing project.

(ii) A description of the potential or actual compliance violation or default situation, including an explanation of related causes, such as cash flow concerns, budget revisions, deferred maintenance, vacancies, or violations of statutes.

(iii) A definition and description of the housing project's market area, including information on housing availability, rents, and vacancy rates in the market area.

(iv) A description of the proposed actions to prevent or correct compliance violations or to cure defaults along with a date specific schedule indicating when interim and final actions will be taken to correct the compliance violation or cure the default.

(v) A description of financial and other resources necessary to prevent or correct the compliance violation or cure

the default including an identification of the sources for such resources.

(d) *Workout agreement budgets.*

Budget revisions submitted as a part of a workout agreement for a housing project experiencing cash flow problems must prioritize cash disbursements in the following order:

- (1) Prior lienholder, if any;
- (2) Critical operating and maintenance expenses, including taxes and insurance;
- (3) Agency debt payments;
- (4) Reserve account requirements; and
- (5) Other authorized expenditures.

(e) *Workout agreement terms and cancellation.* (1) Workout agreements shall be in effect for no longer than a 2-year time period, beginning on the date of Agency approval. If an approved workout agreement calls for actions that extend beyond a 2-year period, borrowers must submit an updated and, if necessary, revised workout agreement to the Agency for approval. The updated workout agreement must be submitted to the Agency, 30 days prior to the expiration of the workout agreement in effect.

(2) The Agency may cancel a workout agreement at any time if the borrower fails to comply with the terms of the agreement. The Agency will provide notice to the borrower upon cancellation of the workout agreement.

**§ 3560.454 Special servicing actions related to housing operations.**

(a) *Changing rents or revising budgets.* The Agency may approve a borrower request for a rent change, rent incentives, or a revised budget, at any time during a housing project's fiscal year.

(b) *Occupancy waivers.* If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by allowing the borrower to accept as tenants persons with incomes above the income eligibility standards specified in § 3560.152(a), the Agency, in writing, may grant the borrower an occupancy waiver to allow such persons as tenants. Occupancy waivers will be in effect only during the time period specified by the Agency when the waiver is granted. In addition, borrowers must rent to all eligible applicants on the housing projects waiting list prior to accepting persons with incomes above the Agency standards as tenants.

(c) *Additional rental assistance (RA).* If the Agency determines that a housing project with high vacancies could be kept operationally and financially viable by increasing the amount of RA allocated to the housing project, the Agency, subject to available funds, may

offer the housing project RA as a means of preventing or correcting a compliance violation or curing a default.

(d) *Special note rents.* When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may approve a rent less than the note rent to attract and keep tenants whose incomes, according to the formula in § 3560.203, would require them to pay the note rent. The reduced rent is called a Special Note Rent (SNR) and, as noted in § 3560.210, approval of an SNR may affect approvals of loan proposals submitted to the Agency for the market area where the SNR is in effect.

(1) An SNR rent may only be requested as a part of a proposed workout agreement and must include documentation of market conditions, the housing project's vacancy rates, evidence of marketing efforts, and other concerns necessitating the request for an SNR.

(2) Borrowers must forego the annual return to owner for each housing project's fiscal year that an SNR is in effect for all or part of a fiscal year at a housing project.

(3) SNR's may be increased, decreased, or terminated any time during a housing project's fiscal year when market conditions, vacancy rates, or other concerns that necessitated the SNR warrant a change.

(4) In addition to any state lease law requirements that might be related to the implementation of an SNR, the borrower must notify each tenant of any change in rents or utility allowances that result from approval of an SNR, in accordance with § 3560.205(c) and must submit the appropriate budget changes to the Agency for approval.

(e) *Termination of management agreement.* If the Agency determines that a compliance violation or loan default was caused, in full or in part, by actions or inactions of the housing project's management agent, the Agency will require the borrower to terminate the management agreement with that agent, or in the case of a borrower managed housing project, to enter an agreement with a third-party non-identity of interest management agent, unless the borrower and the Agency agree on a written plan to prevent reoccurrence of the violation. Housing project funds may not be used to pay a management fee to a management agent after the Agency has directed the borrower to terminate a management agreement with that agent, except during an Agency approved transition period.

**§ 3560.455 Special servicing actions related to loan accounts.**

(a) *General.* To prevent or correct a compliance violation or to prevent or cure a default in a situation that cannot be resolved through regular servicing, the Agency may approve a deferral of loan payments or a loan restructuring. Nothing herein precludes the Agency from initiating appropriate legal action to correct a compliance violation if the Agency determines such action is more in the Government's interest than entering into a special servicing agreement as provided for in this section. Procedures for debt collection are discussed in § 3560.460. As part of a workout agreement, the Agency may agree to accept less than full monthly payment installments due on an Agency loan for a specified period of time, not to exceed the effective period of the workout agreement.

(b) *Loan reamortizations.* A loan reamortization is a restructuring of loan terms and conditions over a period of time that does not exceed the remaining useful life of the housing project.

(1) Loan reamortizations will only be approved when they are in the best interest of the Federal Government and tenants and when the following conditions are met.

(i) The Agency determines that the borrower will be unable to meet their obligations without a reduction in monthly payment installments; and

(ii) The Agency is satisfied that the security, including the potential income for debt service, will be adequate to protect the Agency's interest over the term of the reamortization and that the reamortization will not adversely affect the Federal Government's lien priority.

(2) If the Agency approves a reamortization of a loan under this section, it will be at the existing note rate, or the current interest rate at the time of reamortization closing or approval, whichever is less.

(3) Loan reamortization may be used to:

(i) Restructure loan repayments to prevent or correct a compliance violation or cure a default caused by circumstances beyond the borrower's control in situations where the borrower is otherwise in compliance with Agency requirements;

(ii) Repay principal, outstanding interest, overage, and advances made by the Agency for recoverable cost items when less than full payments were authorized under the provisions of an Agency approved workout agreement;

(iii) Restructure a borrower's loan payments in conjunction with an incentive package developed in

accordance with § 3560.656 to prevent prepayment of the loan;

(iv) Restructure an existing loan in conjunction with a subsequent loan for rehabilitation; or

(v) Restructure remaining debt when a portion of the property serving as loan security is sold and there is a need to reestablish the financial stability of the housing project.

(c) *Loan writedowns.* A loan writedown is a reduction of a borrower's debt approved by the Agency.

(1) Loan writedowns will only be approved when they are in the best interest of the Federal Government and when the following conditions exist:

(i) Sound management of the housing project is evident or sound management practices are proposed for correction in accordance with an Agency approved workout agreement; and

(ii) The housing project's financial stability is being affected by conditions beyond the borrower's control, such as market weaknesses, unforeseen site problems, or natural disasters.

(2) Prior to Agency approval for a loan writedown, the borrower must obtain an appraisal of the housing project that concludes the "as-is" market value," subject to restricted rents, conducted in accordance with subpart P of this part. The Agency will not approve a loan write-down unless the appraisal indicates the Federal Government's interests are secured at the proposed writedown level.

(3) Any writedown will be conditioned on a finding that the borrower does not have the ability to pay a higher loan payment, even if the loan is reamortized.

(4) Loan writedowns may be used to allow for a loan transfer and assumption for less than the total amount of outstanding debt.

#### **§ 3560.456 Liquidation.**

Prior to any servicing action which might lead to the acquisition of real property by the Agency, the Agency must complete a due diligence report to assess any potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products. The borrower must cooperate with the Agency in the development of this report.

(a) *Before acceleration.* Before accelerating a project loan, the Agency will consider the possibility that the borrower is forcing an acceleration to circumvent the prepayment process. If it is found that this is the borrower's motivation, the Agency will consider alternatives to acceleration, such as suing for specific performance under loan and management documents.

(b) *Acceleration.* When a borrower is in monetary or non-monetary default, the Agency will accelerate the loan unless the Agency decides other enforcement measures are more appropriate.

(1) If the borrower does not pay the full account balance and meet the other terms of the acceleration notice within the time period set forth in the acceleration notice, the Agency will foreclose or acquire the security property through deed in lieu of foreclosure.

(2) The Agency will suspend interest credit and rental assistance.

(3) The Agency will not accept partial payment of an accelerated loan unless required by state law.

(c) *Voluntary liquidation.* After acceleration, borrowers may voluntarily liquidate through either of the following mechanisms:

(1) *Deed in lieu of foreclosure.* RHS may accept a deed in lieu of foreclosure to convey title to the security property only after the debt has been accelerated and when it is in the Government's best interest.

(2) *Offer by third party.* If a junior lienholder or cosigner makes an offer in the amount of at least the net recovery value, RHS may assign the note and mortgage after all appeal rights have expired.

(d) *Foreclosure.* (1) The Agency will initiate foreclosure when a borrower is in monetary or non-monetary default and foreclosure is in the best interest of the Federal Government.

(2) When a junior lienholder foreclosure does not result in payment in full of the Agency debt but the property is sold subject to the Agency lien, the Agency will liquidate the account.

(e) *Acquisition of chattel properties.* (1) The Agency will accept voluntary conveyance of chattel property only when the borrower can convey ownership free of other liens and the Agency has agreed to release the borrower from further liability on the account.

(2) If the Agency decides to accept an offer of voluntary conveyance of chattel property, the borrower must provide an itemized listing of each chattel property item being conveyed and provide title to vehicles or other equipment, where applicable.

#### **§ 3560.457 Negotiated debt settlement.**

(a) *Borrower proposals to settle debt.* A borrower who cannot pay the full amount of loan payments may propose an offer to settle an outstanding debt for less than the full amount of that debt. The Agency may approve a negotiated

debt settlement only in cases where a default is evident and doing so is in the best interest of the Federal Government and tenants.

(b) *Required information.* Borrowers requesting debt settlement must submit complete and accurate information from which a full determination of financial condition can be made. Debt settlement offers will not be approved by the Agency unless the financial information submitted by the borrower indicates that the borrower will be able to make the debt settlement payments as proposed.

(c) *Effective date of approval.* Debt settlement offers will not be accepted until the borrower receives written approval from the Agency.

(d) *Appraisal requirement.* No debt settlement offer will be accepted for less than the net recovery value of the security as determined by a licensed appraiser or other qualified official, and concurred in by the Agency's qualified appraisal review official or other qualified official.

(e) *Disposition of security prior to offer.* Borrowers are not required to dispose of security prior to making a debt settlement offer. However, if a borrower has disposed of security prior to making a debt settlement offer, the proceeds from the disposed security must be applied to the borrower's account prior to any negotiations on the debt settlement offer.

(f) *Final release condition.* Upon full payment of the approved debt settlement, the Agency will release the borrower from liability.

#### **§ 3560.458 Special property circumstances.**

(a) *Abandonment.* When the Agency determines that a borrower has abandoned security for a loan under this part, the Agency will take the steps necessary to protect the Federal Government's interest in the security. Costs associated with managing abandoned property are the responsibility of the borrower and will be charged to the borrower's account until liquidation is completed.

(b) *Other security.* The Agency will service security such as collateral assignments, assignments of rents, Housing Assistance Payments Contracts, and notices of lienholder interest according to acceptable practices in the respective states.

(c) *Taking of additional security to protect Agency interests.* The Agency may require borrowers to provide additional security in the form of real estate, cash reserves, letters of credit, or other security when needed to improve the chances that the Agency will not suffer a loss, and when:

- (1) The account is in default; or
- (2) The property has not been properly managed or maintained.

(d) *Due diligence.* When the Agency has completed an environmental review in accordance with 7 CFR part 1940, subpart G, and decides not to acquire security property through liquidation action or chooses to abandon its security interest in real property, whether due in whole or in part, to the presence of contamination from hazardous substances, hazardous wastes, or petroleum products, the Agency will provide the appropriate environmental authorities with a copy of its due diligence report.

**§ 3560.459 Special borrower circumstances.**

(a) *Deceased borrower, bankruptcy, insolvency, and divorce actions.* The Agency will address borrower accounts affected by special circumstances such as death, bankruptcy, insolvency, and divorce on a case-by-case basis. The Agency will make servicing decisions in such cases on the basis of best interest to the Federal Government and tenants. The Agency will bring a legal action to establish the legal capacity of the borrower to administer the project if found necessary to protect the government's interests. In order for the Agency to make servicing decisions in such cases, the borrower or the borrower's representative will provide to the Agency:

- (1) On the part of the heirs or executor of the borrower's estate, evidence of legal action due to a will or court actions that establish who is to become the owner;
- (2) The financial status of the borrower and any member pledging additional security for the debt;
- (3) The status of the security property; and
- (4) The impact of the identified actions on the operation of the project.

(b) *Membership liability agreements.* If a borrower's note is endorsed by individuals other than the borrower or a borrower has security agreements with members of the organization for the purchase of shares of stock or for the payment of a pro rata share of the loan in the event of default, or has individual liability agreements, which are usually assigned to and held by the Agency as additional security for the loan, the security and liability agreements must be adequate to protect the Agency's interest.

(c) *Security issues in participation loans.* When a multi-family housing (MFH) project is receiving financing or a subsidy from sources other than the Agency, the Agency will service the

account in accordance with the participation agreements made with the Agency and the other funding sources under § 3560.65.

**§ 3560.460 Double damages.**

(a) *Action to recover assets or income.*

(1) The Agency may request to the Attorney General to bring an action in a United States district court to recover any assets or income used by any person in violation of the provisions of a loan made by the Agency under this section or in violation of any applicable statute or regulation.

(2) For the purposes of this section, a use of assets or income in violation of the applicable loan, statute, or regulation includes any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the project or for which the documentation has not been maintained in accordance with the requirements of the Agency and in reasonable condition for proper audit.

(3) For the purposes of this section, the term "person" means:

- (i) Any individual or entity that borrows funds in accordance with programs authorized by this section;
- (ii) Any individual or entity holding 25 percent or more interest in any entity that the Agency funds in accordance with programs authorized by this section; and
- (iii) Any officer, director, or partner of an entity that borrows funds in accordance with programs authorized by this section.

(b) *Amount recoverable.* (1) In any judgment favorable to the United States entered under this section, the Attorney General may recover double the value of the assets and income of the project that the court determines to have been used in violation of the provisions of a loan made by the Agency under this section or any applicable statute or regulation, plus all costs related to the actions, including reasonable attorney and auditing fees.

(2) Notwithstanding any other provisions of law, the Agency may use amounts recovered under this section for activities authorized under this section and such funds must remain available for such use until expended.

(c) *Time limitation.* Notwithstanding any other provisions of law, an action under this section may be commenced at any time during the six-year period beginning on the date that the Agency discovered or should have discovered the violation of the provisions of this section or any related statutes or regulations.

(d) *Continued availability of other remedies.* The remedy provided in this section is in addition to and not in substitution of any other remedies available to the Agency or the United States.

**§ 3560.461 Enforcement provisions.**

(a) *Equity skimming.* (1) *Criminal penalty.* Whoever, as an owner, agent, employee, or manager, or is otherwise in custody, control, or possession of property that is security for a loan made under this title, willfully uses, or authorizes the use, of any part of the rents, assets, proceeds, income, or other funds derived from such property, for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title or the regulations adopted pursuant to this title, must be fined under title 18, United States Code, or imprisoned not more than five years, or both.

(2) *Civil sanctions.* An entity or individual who as an owner, operator, employee, or manager, or who acts as an agency for a property that is security for a loan made under this title where any part of the rents, assets, proceeds, income, or other funds derived from such property are used for any purpose other than to meet actual, reasonable, and necessary expenses of the property, or for any other purpose not authorized by this title of the regulations adopted pursuant to this title, must be subject to a fine of not more than \$25,000 per violation. The sanctions provided in this paragraph may be imposed in addition to any other civil sanctions or civil monetary penalties authorized by law.

(b) *Civil monetary penalties.* (1) *When civil monetary penalties may be imposed.* The Agency may, after notice and opportunity for a hearing, impose a civil monetary penalty in accordance with this section against any individual or entity, including its owners, officers, general partners, limited partners, or employees, who knowingly and materially violate, or participate in the violation of, the provisions of this title, the regulation issued by the Agency pursuant to this title, or agreements made in accordance to this title by:

- (i) Submitting information to the Agency that is false.
- (ii) Providing the Agency with false certifications.
- (iii) Failing to submit information requested by the Agency in a timely manner.

(iv) Failing to maintain the property subject to loans made under this title in good repair and condition, as determined by the Agency.

(v) Failing to provide management for a project that received a loan made under this title that is acceptable to the Agency.

(vi) Failing to comply with the provisions of applicable civil rights statutes and regulations.

(2) *Amount.* (i) The amount of a civil penalty imposed under this section must not exceed the greater of twice the damages the Agency or the project that is secured for a loan under this section suffered or would have suffered as a result of the violation, or \$50,000 per violation.

(ii) Determination. In determining the amount of a civil monetary penalty under this section, the Agency must take into consideration:

- (A) The gravity of the offense;
- (B) Any history of prior offenses by the violator (including offenses occurring prior to the enactment of this section);
- (C) Any injury to tenants;
- (D) Any injury to the public;
- (E) Any benefits received by the violator as a result of the violation;
- (F) Deterrence of future violations; and

(G) Such other factors as the Agency may establish by regulation.

(3) *Payment of penalties.* No payment of a penalty assessed under this section may be made from funds provided under this title or from funds of a project which serve as security for a loan made under this title.

(4) *Remedies for noncompliance.* (i) *Judicial intervention.* If a person or entity fails to comply with a final determination by the Agency imposing a civil monetary penalty, the Agency may request the Attorney General of the United States to bring an action in an appropriate district court to obtain a monetary judgment against such an individual or entity and such other relief as may be available. The monetary judgment may, in the court's discretion, include attorney's fees and other expenses incurred by the United States in connection with the action.

(ii) *Reviewability of determination.* In an action under this paragraph, the validity and appropriateness of a determination by the Agency imposing the penalty must not be subject to review.

(c) *Conditions for renewal extension.* The Agency may require that expiring loan or assistance agreements entered into under this title must not be renewed or extended unless the owner executes an agreement to comply with additional conditions prescribed by the Agency, or executes a new loan or assistance agreement in the form prescribed by the Agency.

#### **§ 3560.462 Money laundering.**

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 95, section 1956(c)(7)(D).

#### **§ 3560.463 Obstruction of Federal audits.**

The Agency will act in accordance with U.S. Code Title 18, part I, chapter 73, section 1516(a).

#### **§§ 3560.464–3560.499 [Reserved]**

#### **§ 3560.500 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

### **Subpart K—Management and Disposition of Real Estate Owned (REO) Properties**

#### **§ 3560.501 General.**

This subpart contains Agency procedures and other policies related to the management and disposition of multi-family housing (MFH) projects in the Agency's inventory (Real Estate Owned (REO) property). Housing projects will not be accepted into the Agency's inventory unless one of the following has occurred:

- (a) The borrower has abandoned the housing project and the Agency has performed the required steps to take the housing project into custody.
- (b) The housing project title has been transferred to the Agency as a result of foreclosure, voluntary conveyance, redemption, or other action.

#### **§ 3560.502 Tenant notifications and assistance.**

Each tenant in an REO property designated to be sold as a non-program property will be notified by the Agency, in writing, of the housing projects' non-program designation and will be given an opportunity to obtain a Letter Of Priority Entitlement (LOPE) as specified in § 3560.159(c).

#### **§ 3560.503 Disposition of REO property.**

(a) Preference will be given to offers from bidders who are determined eligible by the Agency to purchase REO

property designated to be sold as program property. It is the Agency's priority that property previously operated as program property prior to becoming REO inventory property be sold as program property. However, REO property may be sold under whatever Agency program is most appropriate for the property and the community needs regardless of the program under which the property was originally financed or whether the property was being used to secure loans under more than one Agency program.

(b) When the Agency determines that the REO property to be sold is not decent, safe, and sanitary and/or does not meet cost effective energy conservation standards, it will disclose the basis for this determination to prospective purchasers. The deed by which such an REO property is conveyed will contain a covenant restricting it from residential use until it is decent, safe, and sanitary, and meets the Agency's cost effective conservation standards. The Agency will also notify any potential purchaser of any known lead based paint hazards.

#### **§ 3560.504 Sales price and bidding process.**

(a) The loan documents related to REO property sold for program purposes must contain the restrictive-use language specified in § 3560.662(a).

(b) Entities bidding on REO property designated to be sold as program property must submit a loan application package that meets the requirements specified in subpart B of this part.

(1) Bidders on REO property designated to be sold as program property must meet the eligibility requirements established under § 3560.55.

(2) Bidders determined by the Agency to be ineligible to purchase REO property designated to be sold as program property will be notified in writing. The bidding process will continue regardless of pending appeals.

(3) All offers from bidders determined to be eligible to purchase REO property designated to be sold as program property will be considered in the bidding process and must provide evidence of financial stability and credit worthiness.

(c) The Agency will determine the successful bidder on REO property designated to be sold as program property by conducting a drawing of sealed bids.

(1) The Agency may authorize the sale of an REO property by sealed bid or public auction when it is in the best interest of the Government. The Agency will publicly solicit requests for sealed

bids and publicize auctions. If the highest bid is lower than the minimum acceptable bid established by the Agency, or if no acceptable bids are received, the Agency may negotiate a sale without further public notice.

(2) Bidders who desire to withdraw their bids must do so prior to the drawing date.

(d) Property designated to be sold as non-program property may be sold to entities that do not meet the Agency's eligible borrower requirements specified in § 3560.55, and must be sold for cash or on terms approved by the Agency. Cash sales will be given first preference and will be drawn before any sales on terms.

**§ 3560.505 Agency loans to finance purchases of REO properties.**

(a) Agency loans to finance the purchase of REO property designated to be sold as program property must meet the same requirements as specified in subparts A and B of this part. In addition, the following provisions apply.

(1) At the borrower's option, the interest rate will be the prevailing rate at the time of loan approval or the prevailing rate at loan closing.

(2) Purchasers may pay closing costs from their own funds or, if allowable under subparts B, L, or M of this part, as applicable, may finance such costs as part of the Agency loan.

(b) Agency loans to finance the purchase of REO property designated to be sold as non-program property must meet the following terms.

(1) A down payment of not less than 10 percent of the purchase price is required at closing.

(2) The interest rate will equal the lesser of the prevailing interest rate at the time of loan approval or loan closing for MFH loans plus one-half percent.

(3) The note amount will be amortized over a period not to exceed 10 years. If the Agency determines that more favorable terms are necessary to facilitate the sale, the note amount may be amortized using a 30-year factor with payment in full due no later than 10 years from the date of closing (balloon payment). In no case will the term be longer than the useful life of the property.

(4) Agency loans to finance the purchase of non-program REO property are subject to the availability of funds.

(c) Loan limits and allowable uses of loan funds specified in subparts B, L, and M of this part, as applicable, are applicable to any Agency-financed (credit) sale of REO property.

(d) Title clearance and loan closing for an Agency financed sale and any

subsequent loan to be closed simultaneously with the sale must meet the requirements in subpart B of this part for an initial loan, with the following exceptions:

(1) A "Quit Claim" or other non-warranty deed will be used; and

(2) The buyer must pay attorney's fees, insurance costs, recording fees and other customary fees unless they are included in a subsequent loan and the subsequent loan is for purposes other than closing costs and fees.

(e) After approval of an Agency-financed sale of occupied REO property designated to be sold as program property, but prior to closing, the purchaser must prepare a budget for housing operations in accordance with subpart B of this part. If a rent increase is necessary, procedures specified in subparts E and F of this part for calculating rents, net tenant contributions, and rental assistance will be followed by the borrower.

**§ 3560.506 Conversion of single family type REO property to MFH use.**

Single family type REO property may be sold for conversion to MFH program use under the following conditions:

(a) The Agency will allow nonprofit organizations, public bodies, or for-profit entities to purchase single family type REO property for conversion to MFH program use. When the Agency finances the sale of single family-type REO property for conversion to rural rental housing program use (*i.e.*, MFH including group homes and homes for the elderly or disabled, farm labor housing, or rural cooperative housing), the sale price will be the lesser of the Federal Government's investment or an amount based on the "as-is" market value of the housing project as determined by an appraisal conducted in accordance with subpart P of this part.

(b) The Agency will only accept written offers to purchase two or more single family type REO properties for conversion to rural rental housing from nonprofit organizations, public bodies, or for-profit entities with a good record of providing housing under the Agency's MFH programs. The single family type properties are not required to be contiguous, however, they must be located in close enough proximity so that management capabilities are not diminished because of distance.

**§§ 3560.507–3560.549 [Reserved]**

**§ 3560.550 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget

(OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart L—Off-Farm Labor Housing**

**§ 3560.551 General.**

This subpart establishes the requirements for making loans and grants for off-farm labor housing and for ongoing operations of this housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to the requirements in this subpart.

**§ 3560.552 Program objectives.**

(a) In addition to the objectives stated in § 3560.52, off-farm labor housing loan and grant funds will be used to increase:

- (1) The supply of affordable housing for farm labor; and
- (2) The ability of communities to attract farm labor by providing housing which is affordable, decent, safe and sanitary.

(b) Under section 516(i) of the Housing Act of 1949 (42 U.S.C. 1486(i)), the Agency may award technical assistance grants to encourage the development of farm labor housing.

**§ 3560.553 Loan and grant purposes.**

(a) In addition to the purposes stated in § 3560.53, off-farm labor housing loan and grant funds may be used to provide facilities for seasonal or temporary residential use with appropriate furnishings and equipment. A temporary residence is a dwelling which is used for occupancy, usually for a short period of time, but is not the legal domicile for the occupant.

(b) The Agency may award technical assistance grants to eligible private and public nonprofit agencies. These grant recipients will, in turn, assist other organizations to obtain loans and grants for the construction of farm labor housing.

(c) Technical assistance services may not be used to reimburse a nonprofit or public body applicant for technical services provided by a nonprofit organization, with housing and/or community development experience, to assist the nonprofit applicant entity in

the development and packaging of its loan/grant docket and project. In addition, technical assistance will not be funded by the Agency when an identity of interest exists between the technical assistance provider and the loan or grant applicant.

**§ 3560.554 Use of funds restrictions.**

Off-farm labor housing loan and grant funds may not be used for any purpose prohibited by § 3560.54 except § 3560.54(a)(1). Off-farm labor housing may be used to serve migrant farmworkers.

**§ 3560.555 Eligibility requirements for off-farm labor housing loans and grants.**

(a) *Eligibility for loans.* Applicants for off-farm labor housing loans must be:

(1) A broad-based nonprofit organization, a nonprofit organization of farmworkers, a federally recognized Indian tribe, a community organization, or an agency or political subdivision of State or local government, and must meet the requirements of § 3560.55, excluding § 3560.55(a)(6). A broad-based nonprofit organization is a nonprofit organization that has a membership that reflects a variety of interests in the area where the housing will be located; or

(2) A limited partnership with a nonprofit general partner which meets the requirements of § 3560.55(d).

(b) *Eligibility for grants.* To be eligible for off-farm labor housing grants, applicants must:

(1) Meet the requirements in § 3560.555(a)(1); and

(2) Be able to contribute at least one-tenth of the total farm labor housing development cost from its own or other resources. The applicant's contribution must be available at the time of grant closing. An off-farm labor housing loan financed by RHS may be used to meet this requirement.

(c) *Limitation.* Limited partnerships eligible under paragraph (a)(2) of this section are not eligible for farm labor housing grants.

**§ 3560.556 Application requirements and processing.**

Off-farm loans and grants will be available under a Notice of Funding Availability (NOFA) that will be published in the **Federal Register** each fiscal year.

**§ 3560.557 [Reserved]**

**§ 3560.558 Site requirements.**

The requirements established in § 3560.58 apply to all applications for off-farm labor housing loans and grants except that off-farm labor housing are not limited to rural areas.

**§ 3560.559 Design and construction requirements.**

(a) *General.* The requirements established in § 3560.60 apply to all applications for off-farm labor housing loans and grants except that seasonal off-farm labor housing that will be occupied for eight months or less per year by migrant farmworkers while they are away from their residence, may be constructed in accordance with Exhibit I of 7 CFR part 1924, subpart A.

(b) *Additional requirements.* In addition to the requirements established in § 3560.60, it is encouraged that the design of off-farm labor housing incorporate outdoor shower, boot washing station, and/or hose bibb facilities as necessary to protect the resident and the asset from excess dirt and chemical exposure.

(c) *Davis-Bacon wage requirements.* Construction financed with the assistance of a Section 516 grant will be subject to the provisions of the Davis-Bacon Act (40 U.S.C. 276(a)-276(a)(7)), and the implementing regulations published by the Department of Labor at 29 CFR parts 1, 3, and 5.

**§ 3560.560 Security.**

The security requirements established in § 3560.61 will apply to all applications for off-farm labor housing loans.

**§ 3560.561 Technical, legal, insurance and other services.**

The requirements established under § 3560.62 apply to all applications for off-farm labor housing loans and grants.

**§ 3560.562 Loan and grant limits.**

(a) *Determining the security value.* The requirements established under § 3560.63(a) apply to off-farm labor housing loans.

(b) *Maximum amount of loan.* The requirements established in § 3560.63(c)(1) and (2), regarding borrower equity contribution apply to all applications for off-farm labor housing loans. (For applicants eligible under § 3560.555(a)(2), the amount of Agency financing for the housing will not exceed 95 percent of the total development cost or 95 percent of the security value available for the Agency loan, whichever is lower.) In determining the amount of the loan, the Agency will also review the capacity of the applicant to amortize such loan, considering any rental assistance provided for use in the housing, and any rents anticipated to be paid by farmworkers expected to occupy the housing.

(c) *Maximum amount of grant.* The amount of any off-farm labor housing grant must not exceed the lesser of:

(1) Ninety percent of the total development cost, or

(2) That portion of the total development cost which exceeds the sum of any amount provided by the applicant from their own resources plus the amount of any loans approved for the applicant, considering the capacity of the applicant to amortize the loan.

**§ 3560.563 Initial operating capital.**

The requirements for § 3560.64 apply to all applications for off-farm labor housing loans and grants.

**§ 3560.564 Reserve accounts.**

The requirements for § 3560.65 apply to all applications for off-farm labor housing loans and grants.

**§ 3560.565 Participation with other funding or financing sources.**

The requirements established in § 3560.66 apply to all applications for off-farm labor housing loans and grants, except that the 25 percent requirements stated in paragraph § 3560.66(b)(1) may consist of loan and/or grant funds.

**§ 3560.566 Loan and grant rates and terms.**

(a) *Amortization period.* The loan will be amortized over a period not to exceed 33 years. The amortization schedule will take into account the depreciation of the security and ensure that the loan will be adequately secured.

(b) *Interest rate.* The effective interest rate will be 1 percent.

(c) *Term of grant agreement.* The grant agreement will remain in effect for so long as there is a need for farm labor housing.

**§ 3560.567 Establishing the profit base on initial investment.**

The requirements established under § 3560.68 apply to applicants eligible under § 3560.555(a)(2) and operating as a limited partnership with a nonprofit general partner.

**§ 3560.568 Supplemental requirements for seasonal off-farm labor housing.**

For off-farm labor housing operating on a seasonal basis, the management plan must establish specific opening and closing dates. During the off-season, off-farm labor housing may be used as defined in subpart A of this part under short-term lease provisions. Where rents are charged on a per-unit basis and family income qualifies the household for rental assistance, rental assistance may be used.

**§ 3560.569 Supplemental requirements for manufactured housing.**

The requirements established in § 3560.70 apply to all applications for off-farm labor housing loans and grants.

**§ 3560.570 Construction financing.**

The requirements established in § 3560.71 apply to all applications involving off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) Equity contributions being made by a borrower or grantee must be contributed and disbursed prior to any disbursement of interim loan funds and any loan or grant funds from the Agency.

(b) If the Agency is providing both loan and grant funds, loan funds must be fully released and expended prior to the release of grant funds by the Agency.

(c) If construction is financed with a Labor Housing grant, it is subject to the provisions of the Davis-Bacon Act (published in the Department of Labor regulations 29 CFR parts 1, 2, and 5).

**§ 3560.571 Loan and grant closing.**

The requirements established in § 3560.72 apply to all applications for off-farm labor housing loans and grants. In addition, the following requirements apply.

(a) A nonprofit organization will have its Board of Directors adopt an Agency-approved loan and/or grant resolution, which is required as part of the loan docket before loan and/or grant approval. All other loan applicants will execute an Agency-approved loan agreement.

(b) For grants, an Agency approved grant agreement, must be executed by the applicant on the date of grant closing.

(c) The obligations incurred by the applicant, as a condition of accepting the grant, will be in accordance with the off-farm labor housing grant agreement.

(d) Off-farm labor housing loans used to build or acquire new units made pursuant to a contract entered into on or after the effective date of this regulation, will be subject to the restrictive-use provision stated in § 3560.72(a)(2)(ii). All other off-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation. Such restrictions must be included in the mortgage and deed of trust.

**§ 3560.572 Subsequent loans.**

The requirements established in § 3560.73 will apply to all applications for subsequent off-farm labor housing loans.

**§ 3560.573 Rental assistance.**

(a) Rental assistance may be provided to income eligible tenants living in off-farm labor housing in accordance with subpart F of this part. The requirements

established in § 3560.252 apply to all tenants receiving rental assistance.

(b) For dormitory style facilities operating on a per bed basis, rental assistance will be made available to the housing on a per unit basis, but may be pro-rated to tenants on a per bed basis. However, total rent charged for a unit must not exceed conventional rent for comparable units in the area or a similar area and per bed rents must be comparable to per bed rents in the market.

**§ 3560.574 Operating assistance.**

Operating assistance may be used in lieu of tenant-specific rental assistance in off-farm labor housing projects financed under section 514 or section 516(i) of the Housing Act of 1949 (U.S.C. 1486(i)) that serve migrant farmworkers. Owners of eligible projects may choose tenant-specific rental assistance as described in § 3560.573 or operating assistance, or a combination of both, however, any tenant or unit assisted under this section may not receive rental assistance under § 3560.572. The objective of this program is to provide assistance toward the cost of operating the project so that rents may be set at rates that are affordable to very low and low-income migrant farmworkers.

(a) *Project eligibility requirements.* To be eligible for the operating assistance program, projects must be:

(1) Off-farm labor housing projects financed under section 514 or section 516 with units that are for migrant farmworkers. Housing units for year-round farmworker households are ineligible; and

(2) Eligible for the Agency's rental assistance program as defined in § 3560.573.

(b) *Operating assistance limits.* The amount of operating assistance requested by the owner must be based on the project's actual income and expenses and must be approved by the Agency. In the case of a mixed project, the amount of operating assistance must be based on the portion of actual income and expenses that are attributable to the units that are for migrant farmworkers. In no instance may the annual amount of operating assistance exceed 90 percent of the annual operating costs that are attributable to the migrant units.

(c) *Owner responsibilities.* (1) *Requesting for operating assistance program.* Owners of off-farm labor housing projects with units for migrant farmworkers may request operating assistance by submitting a request to the Agency, which must include a budget. The budget must include:

(i) Estimated operating costs for the migrant units, including authorized expenditures such as reserve deposits;

(ii) Proposed rental rates for the migrant units to generate sufficient funds for operating costs of those units, taking into consideration all other sources of project income; and

(iii) Estimated rental income from tenants, based on a tenant contribution of 30 percent of the average adjusted monthly income of migrant farmworker households in the area.

(2) *Requesting operating assistance payments.* Each month, the owner will submit a request for operating assistance to the Agency.

(3) *Verifying tenant income eligibility.* Owners are responsible for verifying tenant income eligibility. Only very low or low-income households are eligible for the operating assistance rents. Households with incomes above the low-income limits must pay the full rent.

(4) *Reporting requirements.* (i) Owners will complete and submit to the Agency tenant certifications to document tenant income and eligibility.

(ii) Owners will complete and submit monthly to the Agency a project worksheet for operating assistance.

(iii) Owners must submit an annual planning budget to the Agency prior to the project's fiscal year.

**§ 3560.575 Rental structure and changes.**

Off-farm labor housing is subject to the tenant contribution and rental unit rent requirements for Plan II housing established under subpart E of this part, except where seasonal housing will be occupied for less than a 3-month period. In such instances the best available and practical income verification methods may be used with prior approval of the Agency.

**§ 3560.576 Occupancy restrictions.**

(a) *Restrictions on conditions of occupancy.* (1) No borrower or grantee will be permitted to require that an occupant work on any particular farm or for any particular owner or interest as a condition of occupancy of the housing.

(2) Tenant selection should be in accordance with the loan agreement, subpart D of this part and § 3560.577.

(3) No borrower or grantee will discriminate, or permit discrimination by any agent, lessee, or other operator in the use or occupancy of the housing or related facilities because of race, color, religion, sex, age, disability, familial status, or national origin.

(b) *Eligible households.* To be eligible for occupancy in off-farm labor housing, households must meet the following requirements.

(1) *Occupational*. An eligible household must include a domestic tenant or co-tenant farm laborer, a retired domestic farm laborer, or a disabled domestic farm laborer.

(2) *Income*. The household must meet the definition of income eligible as established in § 3560.152 and the tenant or co-tenant must receive a substantial portion of income from farm labor employment. To determine if a substantial portion of income is from farm labor employment, the following measures will be used.

(i) For housing rented to farm laborers and owned by public bodies, public or private nonprofit organizations, and limited partnerships when charging rent.

(A) Actual dollars earned from farm labor by domestic farm laborers other than migrant farmworkers must equal at least 65 percent of the annual income limits indicated for the Standard Federal regions as published by the Agency for their particular region of the country. For migrant farmworkers living in seasonal housing the actual dollars earned from farm labor by a domestic farm laborer must equal at least 50 percent of annual income limits indicated for the Standard Federal regions, as published by the Agency.

(B) An alternate measure for determining substantial portion of income when actual earnings are not available may be the duration of time a farm laborer worked on a farm or other farming enterprise as a domestic farmworker during the preceding 12 months. In order to be considered as substantial the farm laborer must have worked at least 110 whole days in farm work. For purposes of this section one whole day is the equivalent of at least 7 hours. When using a period of more than 1 year, a yearly average must amount to at least 110 days per year.

(ii) For housing owned by a farmer, family-farm partnership, family-farm corporation, or an association of farmers which was initially provided on a non-rental basis, a substantial portion of income is earned when housing is provided by the owner as part of employment compensation for farm labor.

(iii) When a natural disaster has occurred, such as a drought, flood, freeze, etc., figures for the 12 months preceding such disaster will be used to determine substantial portion of income under paragraph (b)(2) of this section.

(iv) The tenant who qualifies as a domestic farm laborer residing in a property with a nonrestrictive farm labor clause in the mortgage covenants must not have adjusted income which exceeds the moderate income limit for

the appropriate household size and appropriate geographical area.

(3) *Occupancy*. The household must remain in compliance with the borrower's occupancy policy as established in § 3560.155.

(c) *Tenant eligibility requirements for operating assistance rents*. To be eligible for operating assistance rents, tenants must meet the rental assistance eligibility requirements described in § 3560.573 and in § 3560.252.

(d) *Ineligible tenants*. Tenants who, at any time, fail to meet all the requirements in paragraph (b) of this section will be deemed ineligible for occupancy in off-farm labor housing. Ineligible tenants in off-farm labor housing will be addressed in accordance with the requirements of § 3560.158.

(e) *Non-farm laborer tenants*. When there is a diminished need for housing for persons or families in the above categories, units in off-farm labor housing complexes may be made available to persons or families eligible for occupancy under § 3560.152. Eligible tenants under this section may occupy the labor housing until such time the units are again needed by persons or families eligible under paragraph (b) of this section. As the basis for Agency approval or disapproval of the borrower's determination of diminished need, the borrower must submit a current analysis of need and demand to the Agency, identical to the market analysis that is required of loan applicants in the loan origination process. The borrower's determination and the State Director's recommendation should be forwarded to the National Office for concurrence. The procedures specified in § 3560.158 shall be followed when tenants are required to vacate housing to allow for occupancy by persons eligible under paragraph (b) of this section.

#### § 3560.577 Tenant priorities for labor housing.

Tenant occupancy in off-farm labor housing is based on eligible farm labor certified through the income certification process required by § 3560.152 and is prioritized in the following order.

(a) First priority is to be given to eligible active farm laborer households with first priority going to very low-income households, next priority to low-income households, and last to moderate-income households.

(b) Second priority is given to retired domestic farm laborer households and disabled domestic farm laborer households who were active in the local farm labor market area at the time of retiring or becoming disabled.

Occupancy priority will be given in accordance with paragraph (a) of this section.

(c) Third priority is to be given to retired domestic farm laborer households and disabled domestic farm laborer households who were not active in the local farm labor market at the time of retiring or becoming disabled. Occupancy priority will be given in accordance with paragraph (a) of this section.

#### § 3560.578 Financial management of labor housing.

The requirements established in subpart G of this part will apply to all off-farm labor housing.

#### § 3560.579 Servicing off-farm labor housing.

The requirements established in subparts I and J of this part will apply to all off-farm labor housing. Servicing according to subparts I and J of this part shall apply throughout the term of the loan or grant, whichever is longer.

#### §§ 3560.580–3560.599 [Reserved]

#### § 3560.600 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

#### Subpart M—On-Farm Labor Housing

##### § 3560.601 General.

This subpart contains the requirements for making loans for on-farm labor housing and for ongoing operation and management of on-farm labor housing. Unless otherwise specified in this subpart, the requirements of subparts A through K, N, O, and P of this part will apply in addition to requirements given in this subpart.

##### § 3560.602 Program objectives.

In addition to the objectives stated in § 3560.52, on-farm labor housing funds will be used to increase:

(a) The supply of affordable housing for farm labor; and

(b) The ability of the farmer to provide affordable, decent, safe and sanitary housing for farm workers.

**§ 3560.603 Loan purposes.**

On-farm labor housing loans may be made only for the purposes established in § 3560.553. Grants are not available for on-farm labor housing.

**§ 3560.604 Restrictions on use of funds.**

On-farm labor housing loans may not be used for any purpose prohibited by § 3560.54 except § 3560.54(a)(1). On-farm labor housing may be used to serve migrant workers. In addition, on-farm labor housing loan funds may not be used to provide housing for members of the immediate family of the applicant when the applicant is an individual farm owner, family farm corporation, family farm partnership, or a member of an association of farmers. Immediate family includes mother, father, brothers, sisters, sons, and daughters of the applicant and spouse.

**§ 3560.605 Eligibility requirements.**

(a) To be eligible for an on-farm labor housing loan, the applicant must meet the requirements of § 3560.55(a) with the exception of § 3560.55(a)(1), (5), and (6) and the following requirements.

(1) The applicant must be a farm owner, family farm partnership, family farm corporation, or an association of farmers engaged in agricultural or aquacultural farming operations whose farming operations demonstrate a need for on-farm labor housing and who will own the housing and operate it on a nonprofit basis.

(2) The applicant must agree to use the labor housing to engage in the farming operations of the individual farm owner applicant, or in the farming operations of its members if it is a family farm corporation or partnership, or an association of farmers.

(3) The applicant must, as determined by the Agency, be unable to provide the necessary housing from the applicant's own resources and be unable to obtain credit from any other source upon terms and conditions which the applicant could reasonably be expected to fulfill. If the applicant is an association of farmers or family farm corporation or partnership, the individual members, individually and jointly, must be unable to provide the necessary housing by utilizing their own resources and be unable, by pledging their personal liability, to obtain other credit that would enable them to provide housing for farm workers at rental rates they can afford to pay. The individual resources of family farm corporation or partnership members with less than a 10

percent corporate or partnership interest should not be considered when determining if the applicant can obtain credit elsewhere.

(b) The Agency may make an exception to the requirement that an individual farm owner, family farm corporation, family farm partnership or an association of farmers be unable to obtain the necessary credit elsewhere when all of the following conditions exist:

(1) There is a housing need in the area for domestic farmworkers who are migrants and the applicant will provide such housing; and

(2) There are no qualified state or political subdivisions or public or private nonprofit organizations available, or likely to become available within 12 months of the application, that are willing and able to provide the housing.

(c) When an applicant is determined eligible under paragraph (b) of this section, the interest rate for such loans will be determined in accordance with 7 CFR part 1810, subpart A.

(d) On-farm labor housing that consists of buildings with less than three units is not subject to the requirement that five percent of the units be constructed as fully accessible units, as described in § 3560.60(d).

**§ 3560.606 Application requirements and processing.**

(a) On-farm labor housing loan applications will be processed according to 7 CFR part 1940, subpart L. Applicants must submit an application in an Agency-approved format that adequately documents the need for the housing and the eligibility of the applicant.

(b) The applicant must certify that the farm workers for which the housing is intended are or will be involved in the applicant's agricultural or aquacultural farming operations.

(c) The applicant must certify that housing operations will be conducted in a non-profit manner such that income from the housing does not exceed eligible expenses associated with the housing. Eligible expenditures for the housing include, but are not limited to housing repairs and upkeep, payment of installments on the loan, taxes, insurance and reserves and other essential uses needed for success of the operations.

**§ 3560.607 [Reserved]**

**§ 3560.608 Site and construction requirements.**

(a) *General.* Cost and development standards for on-farm labor housing will be consistent with the requirements,

and cost limits specified in subpart B of this part, if the housing is a multi-family housing type structure, or consistent with section 502 of the Housing Act of 1949, if the housing is a single family type structure.

(b) *Permanent units.* On-farm labor housing occupied for 8 months or more of the year will be required to meet the following requirements.

(1) Housing may be multi-family or single family in type and may be located on the farm away from farm service buildings, or in the nearby community. Single-family type housing is defined as an individual or a group of individual single family detached dwelling units. All sites and housing shall be planned and constructed in accordance with 7 CFR part 1924, subparts A and C.

(2) Sites must be accessible from a public road, when feasible.

(c) *Seasonal units.* On-farm labor housing occupied for less than 8 months of the year will be considered seasonal housing. Such housing must meet the following requirements.

(1) Housing designed for seasonal occupancy may be either single family or multi-family.

(2) Seasonal housing may be constructed in accordance with exhibit I of 7 CFR part 1924, subpart A. If constructed in accordance with exhibit I, the housing must be suitable to allow for conversion to full-year occupancy if the need for migrant farmworkers in the area declines.

(d) *Accessibility.* On-farm labor housing that consists of buildings with less than three units, need not meet the requirement that five percent of the units be constructed as fully accessible units, as described in § 3560.60(d). This does not, however, eliminate any other accessibility requirements.

**§ 3560.609 [Reserved]**

**§ 3560.610 Security.**

(a) Security instruments must meet the requirements established under § 3560.560.

(b) When feasible, the on-farm labor housing will be located on a tract of land that is surveyed such that, for security purposes, it is considered separate and distinct from the farm. The security for the loan must include a lien on the tract of land where the on-farm labor housing is located and the security must have adequate value to protect the Federal government's interest. The Agency will seek a first or parity lien position on Agency-financed property in all instances, however, the Agency may accept a junior lien position if the Federal government's interests are adequately secured.

(c) The Agency will determine the value of the security for the loan in accordance with 7 CFR part 1922, subpart B if the farm is used as security or in accordance with section 502 of the Housing Act of 1949, if only the on-farm labor housing and related land is used for security.

(d) If necessary to provide adequate security for the loan, the Agency may require that any household furnishings purchased with loan funds also be secured.

(e) Personal liability and recourse will be required of all borrowers, including the individual members, stockholders or partners of an association of farmers, family farm corporations or partnerships, respectively.

**§ 3560.611 Technical, legal, insurance and other services.**

When technical, legal, insurance, or services are required for development of on-farm labor housing, applicants must comply with the applicable requirements of § 3560.62. Regarding insurance coverage, the requirements of § 3560.62(d) apply to on-farm labor housing.

**§ 3560.612 Loan limits.**

The maximum loan amount will be 100 percent of the allowable total development costs of on-farm labor housing and related facilities subject to §§ 3560.603, 3560.604 and 3560.608.

**§ 3560.613 [Reserved]**

**§ 3560.614 Reserve accounts.**

When on-farm labor housing operations include 12 or more units, the Agency will require such properties to comply with the reserve account requirements in § 3560.65.

**§ 3560.615 Participation with other funding sources.**

The Agency encourages the use of other funding sources in conjunction with on-farm labor housing loans. Use of such financing in conjunction with an on-farm labor housing loan is subject to the approval of the Agency and must comply with the requirements of § 3560.66.

**§ 3560.616 Rates and terms.**

(a) The interest rate for on-farm labor housing loans will be 1 percent.

(b) The term of the on-farm labor housing loan will not exceed 33 years.

(c) Loan amortization for on-farm labor housing may be on a monthly or an annual basis.

**§ 3560.617 [Reserved]**

**§ 3560.618 Supplemental requirements for on-farm labor housing.**

The management plan for on-farm labor housing operated on a seasonal basis must have specific opening and closing dates. During the off-season, on-farm labor housing may be used under short-term lease provisions.

**§ 3560.619 Supplemental requirements for manufactured housing.**

On-farm labor housing loan funds used for manufactured housing must comply with § 3560.70. Manufactured housing located on-farm may consist of individual units.

**§ 3560.620 Construction financing.**

The requirements established in § 3560.71 apply to all applications involving on-farm labor housing loans.

**§ 3560.621 Loan closing.**

Applicants for on-farm labor housing loans must execute an Agency-approved loan agreement. In addition, if determined appropriate by the Agency, on-farm labor housing loans made on or after the effective date of this regulation may be subject to the restrictive-use provisions as stated in § 3560.72(a)(2)(ii). All other on-farm labor housing loans are subject to the restrictive-use provisions contained in their loan documents and as outlined in subpart N of this regulation.

**§ 3560.622 Subsequent loans.**

The requirements established in § 3560.572 apply to all applications for on-farm labor housing subsequent loans.

**§ 3560.623 Housing management and operations.**

Borrowers with on-farm labor housing loans must:

(a) Develop and submit to the Agency a management plan in a format specified by the Agency. At a minimum, the management plan will detail the borrower's operational and occupancy policies, how the borrower will deal with resident complaints, and how repairs will be completed; and

(b) Maintain a lease or employment contract with each tenant specifying employment with the borrower as a condition for continued occupancy.

**§ 3560.624 Occupancy restrictions.**

(a) The immediate relatives of the borrowers are ineligible occupants for on-farm labor housing.

(b) Occupants must meet the definition of a domestic farm laborer, as defined in § 3560.11.

(a) Occupancy of on-farm labor housing is restricted to employees of the

borrower unless otherwise approved by the Agency.

(d) With prior written permission of the Agency, on-farm labor housing may be occupied by ineligible tenants on a short-term basis. The permission of the Agency must also be for a limited duration.

**§ 3560.625 Maintaining the physical asset.**

On-farm labor housing must meet state and local building and occupancy codes.

**§ 3560.626 Affirmative Fair Housing Marketing Plan.**

On-farm labor housing must meet the requirements of § 3560.104.

**§ 3560.627 Response to resident complaints.**

The management plan submitted in accordance with § 3560.623 (a) will include a provision for dealing with resident complaints.

**§ 3560.628 Establishing and modifying rental charges.**

If it becomes necessary to establish or modify a shelter cost, the borrower must obtain Agency approval as specified in subpart E of this part.

**§ 3560.629 Security deposits.**

Borrowers that require security deposits to be paid by the tenants will be required to comply with the requirements of § 3560.204.

**§ 3560.630 Financial management.**

Financial information must be submitted in an Agency-approved format and will show operation of the housing in a non-profit manner.

**§ 3560.631 Agency monitoring.**

A compliance review and physical inspection will be conducted by the Agency at least once every 3 years. The purpose of this review will be to inspect:

(a) Tenant eligibility documentation;

(b) Financial information on the operation and management of the labor housing, including relevant borrower financial materials;

(c) Payment of taxes, insurance and hazard insurance;

(d) Compliance with the security deposit requirements;

(e) Compliance with the operating plan;

(f) Compliance with the loan agreement;

(g) Compliance with Agency requirements for affordable, decent, safe, and sanitary housing; and

(h) Compliance with civil rights requirements.

**§§ 3560.632–3560.649 [Reserved]****§ 3560.650 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart N—Housing Preservation****§ 3560.651 General.**

(a) This subpart contains the Agency's housing preservation requirements as related to prepayment requests and restrictive-use provisions (RUPs). The requirements of this subpart support the Agency's commitment to the preservation of decent, safe, sanitary, and affordable multi-family housing (MFH) for very low-, low-, and moderate-income households.

(b) The Agency will coordinate, direct, and monitor the Agency's MFH preservation activities from the National Office level.

**§ 3560.652 Prepayment and restrictive-use categories.**

(a) Loans with prepayment prohibitions include:

- (1) Initial section 515 loans made on or after December 15, 1989, and
- (2) Subsequent loans made on or after December 15, 1989, for additional rental units.

(b) Loans without prepayment prohibitions but with restrictive-use provisions include:

- (1) All loans made after December 21, 1979, but prior to December 15, 1989;
- (2) Subsequent loans made on or after December 15, 1989, for purposes other than additional rental units; or
- (3) Loans subsequently restricted by servicing actions including transfers.

(c) Loans without prepayment prohibitions or restrictive-use provisions include all loans made on or before December 21, 1979 or loans that had restrictive-use provisions that have expired. Such loans are eligible to receive incentives subject to the provisions of this subpart.

(d) Loans may be prepaid if another loan or grant from the Agency imposes the same or more stringent restrictive-

use provisions on the housing project covered by the loan being prepaid.

**§ 3560.653 Prepayment requests.**

(a) Borrowers seeking to prepay an Agency loan must submit a written prepayment request to the Agency at least 180 days in advance of the anticipated prepayment date and must obtain Agency approval before the Agency will accept prepayment.

(b) Prior to submitting a prepayment request, borrowers must take whatever actions are necessary to provide the following items:

(1) A clear description of the loan to be prepaid, the housing project covered by the loan being prepaid, and the requested date of prepayment.

(2) A statement documenting the borrower's ability to prepay under the terms specified.

(3) A certification that the borrower will comply with any federal, state, or local laws or regulations which may relate to the prepayment request and a statement of actions needed to assure such compliance.

(4) A copy of lease language to be used during the period between the submission date and the final resolution of the prepayment request notifying tenant applicants that the housing project has submitted a prepayment request to the Agency and explaining the potential affect of the request on the lease.

(5) Borrowers are required to submit a signed release of information form along with the prepayment request. The Agency will notify nonprofit organizations and public bodies involved in providing affordable housing or financial assistance to tenants of the receipt of a borrower's request to prepay their MFH (MFH) loan(s). Additionally, the Agency is to notify nonprofit organizations and public bodies whenever a borrower, who has requested prepayment, is required or elects to offer their property for sale to a nonprofit or public body.

(6) A certification that the borrower has notified all governmental entities involved in providing affordable housing or financial assistance to tenants in the project of the prepayment request and a statement specifying how long financial assistance from such parties will be provided to tenants after prepayment.

(7) A statement affirming that units in the property applying for prepayment will continue to be available for rent by eligible residents during the prepayment process.

(c) The Agency will review complete requests to determine if:

(1) The loan is eligible for prepayment under § 3560.652(b);

(2) The borrower has the ability to prepay; and

(3) The borrower has complied or has the ability to comply with applicable Federal, state, and local laws related to the prepayment request.

(d) If a prepayment request lacks full and complete information on any item, the Agency will return the prepayment request to the borrower with a letter citing the deficiencies in the prepayment request. The Agency will offer borrowers an opportunity, within 30 days following the date of the return, to address the reasons given by the Agency for the return of the prepayment request and will allow the borrower to submit a revised prepayment request.

(e) If the Agency determines that the prepayment request appropriately satisfies all the conditions listed in paragraph (d) of this section, the Agency will process the prepayment request and make a reasonable effort to enter into a new restrictive-use agreement with the borrower in accordance with § 3560.662 or § 3560.655. If the Agency determines that a loan is ineligible for prepayment or the borrower does not have the ability to prepay, the Agency will return the prepayment request to the borrower with a written explanation of the Agency's determinations.

**§ 3560.654 Tenant notification requirements.**

(a) Within 30 calendar days of receiving a complete prepayment request, the Agency will send a prepayment request notice to each tenant in the housing project. Borrowers must post the Agency's prepayment request notice in public areas throughout the housing project from the date of the notice until the final resolution of the prepayment request. The prepayment request notice will establish a date and place where tenants may meet with the Agency to discuss the prepayment request and will advise tenants that:

(1) They may review all information submitted with the prepayment request except financial information regarding the borrower entity, which the Agency will withhold from tenant review unless given written permission for the release of the information from the borrower; and,

(2) They have 30 days from the date of the prepayment request notice to give the Agency comments on the prepayment request.

(b) Borrowers may provide a prepayment request notice of their own directly to tenants and may establish a date and place where tenants may meet

with the borrower to discuss the prepayment request. The Agency and other providers of housing assistance for very-low, low, and moderate-income households may attend a borrower's prepayment request meeting with tenants.

(c) If the Agency agrees to accept prepayment on a loan, the Agency will send a prepayment acceptance notice to each tenant in the housing project at least 60 days prior to the prepayment date. Borrowers must post copies of the Agency's prepayment acceptance notice in public areas throughout the housing project until prepayment is made. If the prepayment acceptance was based on a borrower's agreement to comply with restrictive-use provisions, the notice will describe the restrictive-use provisions that will apply to the housing project after prepayment and the tenant's rights to enforcement of the provisions.

(d) If the borrower withdraws the prepayment request, the Agency will provide a prepayment request cancellation notice to each tenant in the housing project. Borrowers must post copies of the prepayment request cancellation notice in the public areas throughout the housing project for a period of 60 days following the date of the prepayment request cancellation notice.

(e) If the borrower agrees to accept incentives and restrictive-use provisions, the Agency will notify each tenant, in writing, of the agreement and provide a description of the restrictive-use provision.

(f) If a borrower agrees to sell a housing project involved in a prepayment request to a nonprofit organization or public body, the Agency will notify each tenant, in writing, of the proposed sale to a nonprofit organization or public body and will explain the timeframes involved with the proposed sale, any potential impact on tenants, and the actions tenants may take to alleviate any adverse impact. Borrowers must post copies of the Agency's proposed sale notice in public areas throughout the housing project until the housing project is sold or the offer to sell is withdrawn.

(g) If a tenant applicant signs a lease in a housing project for which a prepayment request has been submitted, the borrower must provide the tenant with copies of all notifications provided to tenants by the Agency or the borrower prior to the tenant's occupancy in the housing project.

(h) If a borrower is unable to sell a housing project involved in a prepayment request to a nonprofit organization or public body within 180

days as specified in § 3560.659, the Agency will send a notice to each tenant in the housing project explaining the potential impact of the borrower's inability to sell the housing project on tenants and the actions tenants may take to alleviate any adverse impact. Borrowers must post the Agency's notice in public areas throughout the housing project for a period of 60 days following the date of the notice.

#### **§ 3560.655 Agency requested extension.**

Before accepting an offer to prepay from a borrower with a restricted loan, the Agency must first make a reasonable effort to enter into a new restrictive-use agreement with the borrower. Under this agreement, the borrower would make a binding commitment to extend the low-income use of the housing and related facilities for 20 years for loans with interest credit, beginning on the date on which the new agreement is executed. If the borrower is unwilling to enter into a new restrictive-use provisions and restrictive-use agreement, the Agency should proceed to take the actions described in § 3560.658.

#### **§ 3560.656 Incentives offers.**

(a) The Agency will offer a borrower, who submits a prepayment request meeting the conditions of § 3560.653(d), incentives to agree to the restrictive-use period in § 3560.662 if the following conditions are met:

(1) The market value of the housing project is determined by the Agency, based on an appraisal conducted in accordance with subpart P of this part;

(2) There are no restrictive-use agreements or prepayment prohibitions in affect.

(b) Specific incentives offered will be based on the Agency's assessment of:

(1) The value of the housing project as determined by the Agency based on an "as-is" market value appraisal conducted in accordance with subpart P of this part;

(2) An incentive amount that will provide a fair return to the borrower;

(3) An incentive amount that will not cause basic rents at the housing project to exceed conventional rents for comparable units; except that when determined necessary by the Agency to allow for decent, safe and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs. Basic rents may be allowed to exceed comparable rents for conventional units, but in no case by more than 150% of the comparable rent for conventional unit rent level; and

(4) An incentive amount that will be the least costly alternative for the Federal Government while being consistent with the Agency's commitment to the preservation of housing for very-low, low, and moderate income households in rural areas.

(c) The Agency may offer the following incentives:

(1) The Agency may increase the borrower's annual return on equity by one of the following two methods. The actual withdrawal of the return remains subject to the procedures and conditions for withdrawal specified in subpart G of this part.

(i) The Agency may recognize the borrower's current equity in the housing project. The equity will be determined using an Agency accepted appraisal based on the housing project's value as unsubsidized conventional housing.

(ii) When a current appraisal indicates an equity loan can not be made, the Agency may recognize the borrower's current equity in the housing project at the higher of the original rate of return or the current 15-year Treasury bond rate plus 2 percent rounded to the nearest one-quarter percent. The equity will be determined using the most recent Agency accepted appraisal of the housing project prior to receiving the prepayment request.

(2) The Agency may agree to convert projects without interest credit or with Plan I interest credit to Plan II interest credit or increase the interest credit subsidy for loans with Section 8 assistance to lower the interest rate on the loan and make basic rents more financially feasible.

(3) The Agency may offer additional rental assistance, or an increase in assistance provided under existing contracts under §§ 521(a)(2), 521(a)(5) of the Housing Act of 1949 (42 U.S.C. 1490a(a)(2)) or section 8 of the United States Housing Act of 1937 (42 U.S.C. § 1437f).

(4) The Agency may make an equity loan to the borrower. The equity loan must not adversely affect the borrower's ability to repay other Agency loans held by the borrower and must be made in conformance with the following requirements:

(i) The equity loan must not exceed the difference between the current unpaid loan balance and 90 percent of the housing project's value as determined by an "as-is" market value appraisal conducted in accordance with subpart P of this part.

(ii) Borrowers with farm labor housing loans are not eligible to receive equity loans as incentives.

(iii) If an incentive offer for an equity loan is accepted, the equity loan may be

processed and closed with the borrower or any eligible transferee.

(iv) Excess reserve funds will be used to reduce the amount of an equity loan offered to a borrower.

(v) Equity loans may not be offered unless the Agency determines that other incentives are not adequate to provide a fair return on the investment of the borrower to prevent prepayment of the loan or to prevent displacement of project tenants.

(5) The Agency will offer rental assistance to protect tenants from rent overburden caused by any rent increase as a result of a borrower's acceptance of an incentive offer or tenants who are currently overburdened.

(6) In housing projects with project-based section 8 assistance, the Agency may permit the borrower to receive rents in excess of the amounts determined necessary by the Agency to defray the cost of long-term repair or maintenance of such a project.

(d) The Agency must determine that the combination of assistance provided is necessary to provide a fair return on the investment of the borrower and is the least costly alternative for the Federal Government.

(e) At the time the incentive is developed, the Agency must take into consideration the costs of any deferred maintenance, items in the housing project's operating budget, and any expected long-term repair or replacement costs based on a capital needs assessment developed in accordance with § 3560.103(c). Deferred maintenance may include specific items identified in previous Agency inspections where the borrower has had the opportunity and resources available to take corrective actions and did not.

(1) Deferred maintenance does not include routine repair and replacement that results from normal wear and tear of the physical asset. The amount required for the reserve account to be considered fully funded will be adjusted accordingly. To determine if basic rents exceed conventional rents for comparable units in the area, monthly contributions necessary to obtain the adjusted fully funded reserve account will be included in the calculation of basic rents.

(2) Deferred maintenance including any deficiencies identified in project compliance with section 504 of the Rehabilitation Act of 1973 must be addressed as part of the development of the incentive and must be completed as part of an acceptance agreement of any incentive.

(f) Existing loans must be consolidated, provided consolidation retains the Agency's lien position, and

reamortized in accordance with subparts I and J of this part, provided it maintains feasibility of the housing for the tenants or reduces the debt service or the level of monthly rental assistance.

(g) The borrower must accept or reject the incentive offer within 30 days. If no answer to the offer is received within 30 days, the Agency may consider the incentive offer to be rejected.

(1) If the borrower accepts the incentive offer, procedures outlined in § 3560.657 must be followed.

(2) If the borrower rejects the incentive offer, the borrower must comply with requirements listed in § 3560.658.

#### **§ 3560.657 Processing and closing incentive offers.**

(a) *Borrower responsibilities.* If a borrower accepts the Agency's offer of incentives, the borrower must complete the following actions:

(1) Subject to the Agency's approval, the borrower must legally restrict the use of the project in accordance with and for the number of years stated in § 3560.662.

(2) If the incentive offer accepted includes an equity loan, the borrower must complete an application for the equity loan, and the borrower must continue to qualify as an eligible borrower or transferee in accordance with subpart B of this part.

(3) If the incentive offer accepted includes rent increases, the borrower must follow the rent increase requirements established in subpart E of this part.

(b) *Waiting lists.* If funds for components of incentive offers are limited, the Agency will establish a waiting list of accepted incentive offers for funding in the date order that the complete prepayment request was received.

(c) *Unfunded incentive offers.* If the borrower accepts the incentive offer but the Agency is unable to fund the incentive within 15 months, the borrower may choose one of the following actions:

(1) The borrower may offer to sell the housing project in accordance with § 3650.659. In this case the borrower will be removed from the list of borrowers awaiting incentives.

(2) The borrower may stay on the list of borrowers awaiting incentives until the borrower's incentive offer is funded. The Agency will not negotiate the incentive offer; but, at a borrower's request, may adjust the incentive amount to reflect an updated appraisal, loan balance, and terms of third party financing.

(3) The borrower may withdraw the prepayment request and be removed

from the list of borrowers awaiting incentives and either continue operating the housing project for program purposes and in accordance with Agency requirements or continue processing their prepayment process in accordance with § 3560.658. If the borrower chooses to withdraw their request, the borrower may resubmit an updated prepayment request, at any time, and repeat the prepayment process in accordance with this subpart.

(4) The borrower may elect to obtain a third-party equity loan provided rents will not exceed comparable rents in the market area.

#### **§ 3560.658 Borrower rejection of the incentive offer.**

(a) If a borrower rejects the incentive package offered by the Agency or an Agency request to extended restrictive-use provisions, made in accordance with § 3560.662, the loan will only be prepaid if the borrower elects to agree to the following:

(1) The borrower agrees to sign restrictive-use provisions to extend restrictive-use by 10 years from the date of prepayment, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with § 3560.659.

(2) If restrictive-use provisions are in place, the borrower will agree to sign the restrictive-use provisions, as determined by the Agency, and at the end of the restrictive-use period offer to sell the housing to a qualified nonprofit organization or public body in accordance with § 3560.659.

(3) If restrictive-use provisions are not in place prior to prepayment, the borrower will offer to sell the housing to a qualified nonprofit organization or public body in accordance with § 3560.659.

(b) If the borrower does not elect or agree to enter an agreement in accordance with paragraph (a) of this section, then the Agency will assess the impact of prepayment on two factors: housing opportunities for minorities and the supply of decent, safe, sanitary, and affordable housing in the market area. The Agency will review relevant information to determine the availability of comparable affordable housing for existing tenants in the market area and if minorities in the project, on the waiting list or in the market area will be disproportionately adversely affected by the loss of the affordable rental housing units.

(1) If the Agency determines that prepayment will have an adverse impact on minorities, then the borrower must offer to sell to a qualified nonprofit

organization or public body in accordance with the provisions of paragraph (a) of this section.

(2) If the Agency determines that the prepayment will not have an adverse effect on housing opportunities for minorities but there is not an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant households in the market area, the loan may be prepaid only if the borrower agrees to sign restrictive-use provisions, as determined by the Agency, to protect tenants at the time of prepayment.

(3) If the Agency determines that there is no adverse impact on minorities and there is an adequate supply of decent, safe, and sanitary rental housing affordable to program eligible tenant households in the market area the prepayment will be accepted with no further restriction.

(c) If the borrower agrees to the restrictive-use provisions, as determined by the Agency, the applicable language must be included in the release documents and the borrower must execute a restrictive-use agreement acceptable to the Agency and a deed restriction.

(d) If the borrower will not agree to applicable restrictive-use provisions, as determined by the Agency, the borrower must offer to sell to a nonprofit or public body in accordance with § 3560.659 or withdraw their prepayment request.

**§ 3560.659 Sale or transfer to nonprofit organizations and public bodies.**

(a) *Sales price.* For the purposes of establishing a sales price when a borrower is required or elects to sell a housing project to a nonprofit organization or public body, two independent appraisals will be ordered, one by the Agency and one by the borrower. Both appraisals will conclude market value and be in accordance with subpart P of this part. If the borrower's assessment of the Agency's appraised market value indicates that no further appraisal is needed, the borrower may agree to accept the Agency's appraisal.

(1) The expense of the borrower's appraisal shall be borne by the borrower. The appraiser selected may not have an identity of interest with the borrower.

(2) If the two appraisers fail to agree on the market value, the Agency and the borrower will jointly select an appraiser whose appraisal will be binding on the Agency and the borrower. The Agency and the borrower shall jointly fund the cost of the appraisal.

(b) *Marketing to nonprofit organizations and public bodies.* If a

borrower must offer the property for sale to a nonprofit organization or public body under this paragraph, the borrower must take the following actions to inform appropriate entities of the sale:

(1) The borrower must advertise and offer to sell the project for a minimum of 180 days. The borrower may choose to suspend advertising and other sales efforts while eligibility of an interested purchaser is determined. If the purchaser is determined to be ineligible, the borrower must resume advertising for the balance of the required 180 days.

(2) The Agency will assist the borrower in initially notifying nonprofit organizations and public bodies.

(3) The borrower must provide the nonprofit organizations and public bodies contacted with sufficient information regarding the housing project and its operations for interested purchasers to make an informed decision. The information provided must include the minimum value of the housing project based on the market value determined in accordance with paragraph (a) of this section.

(4) If an interested purchaser requests additional information concerning the housing project, the borrower must promptly provide the requested materials.

(c) *Preference for local nonprofit and public bodies.* Local nonprofit organizations and public bodies have priority over regional and national nonprofit organizations and public bodies. The Agency may determine that no local nonprofit organizations or public bodies are available to purchase the housing project. After this determination, the borrower may accept an offer from a regional or national nonprofit organization or public body.

(d) *Eligible nonprofit organizations.* To be eligible to purchase properties under the conditions of this subpart, nonprofit organizations may not have among its officers or directorate any persons or parties with an identity-of-interest (or any persons or parties related to any person with identity-of-interest) in loans financed under section 515 that have been prepaid. In addition to local nonprofit organizations, eligible nonprofit organizations include regional or national nonprofit organizations or public bodies provided no part of the net earnings of which accrue to the benefit of any member, founder, contributor or individual.

(e) *Requirements for nonprofit organizations and public bodies.* To purchase and operate a housing project, a nonprofit organization or public body must meet the following requirements:

(1) The purchaser must agree to maintain the housing project for very

low- and low-income families or persons for the remaining useful life of the housing and related facilities. However, currently eligible moderate-income tenants will not be required to move.

(2) The purchaser must agree that no subsequent transfer of the housing project will be permitted for the remaining useful life of the housing project unless the Agency determines that the transfer will further the provision of housing for low-income households, or there is no longer a need for the housing project. Language to be included in the deed, conveyance instrument, loan resolution, and assumption agreement (as applicable) is provided in § 3560.662.

(3) The purchaser must demonstrate financial feasibility of the housing project including anticipated funding.

(4) The purchaser must certify to the Agency that no identity-of-interest relationships in accordance with § 3560.102(g). The purchaser must not have any identity of interest with the seller or any borrower that has previously prepaid or requested prepayment of an Agency MFH loan.

(5) The purchaser must complete an Agency-approved application and obtain Agency approval in accordance with subpart B of this part.

(6) The purchaser must make a bona fide offer taking into consideration the value of the housing project as determined in accordance with paragraph (a) of this section.

(f) *Selection priorities.* If more than one qualified nonprofit organization or public body submits an offer to purchase the project at the same time, priority will be given to local nonprofit organizations and public bodies over regional and national nonprofit organizations or public bodies. When selecting between offers equally meeting all other criteria, the borrower will first consider the success of the nonprofit organization's or public body's previous experience in developing and maintaining subsidized housing, with preference given to the most successful. If the offers continue to be equal, the borrower will then consider the number of years experience that the nonprofit organization or public body has had in developing and maintaining subsidized housing, with preference given to the greater number of years.

(g) *Loans made by the Agency or other sources to nonprofit organizations and public bodies.* Agency loans to nonprofit organizations or public bodies may be made for the purposes described in this paragraph. Agency loans will be processed in accordance with subpart B of this part. Loans from other sources

will be approved by the Agency in accordance with subpart I of this part.

(1) Agency loans to nonprofit organizations or public bodies for the purchase of a housing project will be based on the appraised value determined in accordance with paragraph (a) of this section.

(2) With proper justification, an Agency loan may be made to help the nonprofit organization or public body meet the housing project's first year operating expenses if there are insufficient funds in the housing project's general operating and expense account to meet such expenses. An Agency loan, for the purpose of covering first year operating expenses, may not exceed 2 percent of the housing project's appraised value determined in accordance with paragraph (c) of this section.

(h) *Advances for nonprofit organizations and public bodies.* The Agency may make advances, in accordance with section 502(c)(5)(c)(i), not in excess of limits established by Congress to nonprofit organizations or public bodies that are purchasing housing under this subpart. Grant funds may be used to cover any direct costs other than the purchase price, incurred by nonprofit organizations or public bodies in purchasing and assuming responsibility for the housing project.

(i) *Waiting list.* If funds for sales to nonprofit organizations and public bodies are limited, the Agency will add the funding requests to the waiting list for incentives and follow the process established in § 3560.657(b) and (c).

(j) *Withdrawal from sales process.* A borrower may withdraw the prepayment request at any time prior to the sale of the property. The borrower will be responsible for any damages associated with breaking a sales contract established with a nonprofit organization or public body.

(k) *When no offer to purchase is received.* Prepayment with no further restriction may be accepted by the Agency when the borrower agrees to offer the housing project for sale to a nonprofit organization or public body in accordance with § 3560.659 and no good faith offer is received within 180 days from the date that the housing project was advertised for sale to a nonprofit organization or public body, or a good faith offer was received within 180 days from the advertisement date but the offeror was unable to fulfill the terms of the offer within 24 months of the offer date, provided the owner cooperated with the potential purchaser.

#### § 3560.660 Acceptance of prepayments.

(a) When the Agency agrees to accept prepayment, the Agency will notify borrowers, in writing, of the conditions under which the Agency will accept prepayment including the specific restrictive-use provisions to which the borrower has agreed and the date by which the borrower must make the prepayment.

(1) Prepayment must be made 180 days from the date of the Agency's prepayment acceptance notice to the borrower.

(2) If the borrower's prepayment is not received within 180 days of the prepayment acceptance notice and the Agency has not agreed to an alternative date based on a written request from the borrower, the Agency may cancel the prepayment acceptance agreement.

(b) Tenants will be notified of the prepayment acceptance agreement in accordance with § 3560.654(c). If a prepayment is anticipated to result in increased net tenant contributions, displacements or involuntary relocations, the tenants, who are affected by such a circumstance, may request a Letter Of Priority Entitlement (LOPE) in accordance with § 3560.159(c). Tenants must request a LOPE within one year of the prepayment acceptance notice date.

(c) Owners will provide certification stating that they will meet state and local laws prior to prepayment acceptance.

#### § 3560.661 Sale or transfers.

(a) If a sale or transfer is to take place in conjunction with the Agency incentive offer, the sale or transfer must comply with the processing provisions of subpart I of this part.

(b) If a proposed transferee is determined not to be eligible for the transfer and assumption, the borrower will be given an additional 45 days to find another transferee.

(c) In cases where the existing owner is in program non-compliance or default, the Agency may make an offer of incentives contingent on the successful transfer of the housing to an acceptable purchaser. The Agency may offer a smaller incentive or no incentive if the borrower does not agree to transfer the project to an acceptable purchaser, or if the transfer does not take place.

#### § 3560.662 Restrictive-use provisions and agreements.

All restrictions require Agency approval and must be in accordance with the following restrictions:

(a) The undersigned, and any successors in interest, agree to use the property (described herein) in

compliance with 42 U.S.C. 1484 or 1485, whichever is applicable, and applicable regulations and the subsequent amendments, for the purpose of housing:

(1) Very low-, or low-income households when required by § 3560.658(a)(3), or

(2) Very low-, low-, or moderate-income households.

(b) The period of the restriction will be inserted in accordance with the following:

(1) 10 years if required by § 3560.658(a)(1);

(2) The last existing tenant (that occupied the property on the date of prepayment) voluntarily vacates if required by § 3560.658(b)(2);

(3) 30 years if required by § 3560.406(g);

(4) Remaining period of existing restrictive-use provisions and any agreed extension if required by § 3560.655 or § 3560.658 (a)(2);

(5) The remaining useful life of the housing and related facilities if required by § 3560.658(a)(3); and

(6) 20 years in all other cases.

(c) When required by § 3560.658(a)(1) or (a)(2), the undersigned agrees that at the end of the expiration of the period described in paragraph (b) of this section, the property will be offered for sale to a qualified nonprofit organization or public body, in accordance with previously cited statutes and regulations.

(d) The Agency and eligible tenants or applicants may enforce these restrictions.

(e) The undersigned also agrees to:

(1) To set rents, other charges, and conditions of occupancy in a manner to meet these restrictions;

(2) To post an Agency approved notice of this restriction for the tenants of the property;

(3) To adhere to applicable local, state, and Federal laws; and

(4) To obtain Agency concurrence for any rental procedures that deviate from those approved at the time of prepayment, prior to implementation.

(f) The undersigned will be released from these obligations before the termination period in paragraph (b) of this section only when the Agency determines that there is no longer a need for the housing or that financial assistance provided the residents of the housing will no longer be provided due to no fault, action or lack of action on the part of the borrower.

#### § 3560.663 Post-payment responsibilities for loans subject to continued restrictive-use provisions.

(a) If a borrower prepays a loan and the housing project remains subject to

restrictive-use provisions, the requirements of this section apply after prepayment.

(b) Owners of prepaid housing projects will be responsible for ensuring that the restrictive-use provisions agreed to as a condition of prepayment are observed.

(c) Owners must maintain appropriate documentation to demonstrate compliance with the restrictive-use provisions and must make the documentation and the housing project site available for Federal Government inspection upon request.

(1) Owners must document rent increases in accordance with subpart G of this part.

(2) Owners must document tenant eligibility in accordance with § 3560.152.

(3) In an Agency approved format, owners must provide the agency with a signed and dated certification within 30 days of the beginning of each calendar year for the full period of the restrictive-use provisions establishing that the restrictive-use provisions are being met.

(d) Owners must observe Agency policies on tenant grievances as described in § 3560.160. The Agency may enforce restrictive-use provisions through administrative and legal actions. Tenants may enforce the restrictive-use provisions by contacting the Agency or through legal action. The Agency will release the restrictive-use provisions when the Agency conditions have been met.

#### §§ 3560.664–3560.699 [Reserved]

#### § 3560.700 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

#### Subpart O—Unauthorized Assistance

##### § 3560.701 General.

(a) This subpart contains the policies for recapturing unauthorized assistance when the Agency determines that a borrower or tenant was ineligible for, or

improperly used, assistance received from the Agency.

(b) The Agency may seek repayment of any unauthorized assistance provided to a borrower or tenant, plus the cost of collection, regardless of whether the unauthorized assistance was due to errors by the Agency, the borrower, or the tenant.

##### § 3560.702 Unauthorized assistance sources and situations.

(a) Unauthorized assistance can be received by a borrower or tenant in the form of loans, grants, interest credit, rental assistance, or other assistance provided by the Agency including assistance received as a result of an incorrect interest rate being applied to an Agency loan. Agency officials may pursue identification and recapture of unauthorized assistance through any legal remedies available.

(b) Unauthorized assistance may result from situations such as:

(1) Assistance being provided to an ineligible borrower or tenant;

(2) Assistance to an eligible borrower or tenant being used for an unauthorized purpose;

(3) Assistance being obtained as a result of inaccurate, incomplete, or fraudulent information provided by a borrower or tenant; or

(4) Assistance being obtained as a result of errors by the Agency, borrower, or tenant.

##### § 3560.703 Identification of unauthorized assistance.

(a) The Agency will use all available means to identify unauthorized assistance, including Agency monitoring activities, OIG reports, GAO reports, and reports from any source, if the information provided can be substantiated by the Agency.

(b) Borrowers have the primary responsibility for identifying repayment of unauthorized assistance received by tenants.

##### § 3560.704 Unauthorized assistance determination notice.

(a) The Agency will notify borrowers, in writing, when a determination has been made that unauthorized assistance was received by the borrower. Borrowers will notify tenants, in writing, when a determination is made that unauthorized assistance was received by the tenant and will simultaneously send the Agency a copy of the written notice to the tenant.

(b) The unauthorized assistance determination notice is a preliminary notice, not a demand letter. The unauthorized assistance determination notice will:

(1) Specify the reasons the assistance was determined to be unauthorized;

(2) State the amount of unauthorized assistance to be repaid and specify the party responsible for repayment of the unauthorized assistance (*i.e.*, the tenant or borrower) according to the provision of § 3560.708;

(3) Establish a place and time when the person receiving the unauthorized assistance determination notice may meet with the Agency or, in the case of tenants, may meet with the borrower, to discuss issues related to the unauthorized assistance notice such as the establishment of a repayment schedule; and

(4) Advise the borrower or tenant that they may present facts, figures, written records, or other information within a specified period of time which might alter the determination that the assistance received was unauthorized.

(c) Upon request, the Agency or borrower, in the case of tenants, will grant additional time for discussions related to an unauthorized assistance determination notice. Borrowers must notify the Agency of schedule revisions when additional time is granted to a tenant in unauthorized assistance claims.

##### § 3560.705 Recapture of unauthorized assistance.

(a) The Agency will seek repayment of all unauthorized assistance received by a borrower or tenant, plus the cost of collection, to the fullest extent permitted by law. Agency efforts to collect unauthorized assistance may include offsets, the use of private or public collection agents, and any other remedies available. Agency findings related to unauthorized assistance determinations will be referred to credit reporting bureaus and other federal, state, or local agencies with jurisdictions related to the unauthorized assistance findings for suspension, debarment, civil or criminal action to the fullest extent permitted by law.

(b) If a borrower or tenant agrees to repay unauthorized assistance, the amount due will be the amount stated in the unauthorized assistance determination notice unless another amount has been approved by the Agency.

(c) Repayment may be made either with a lump sum payment or through payments made over a period of time. If a borrower or tenant agrees to repay unauthorized assistance, the borrower or tenant proposed repayment schedule must be approved by Agency prior to implementation. Agency approval of a repayment schedule will take into consideration the best interest of the

borrower, the tenant, and the Federal Government.

(d) Borrowers must retain copies of all correspondence and a record of all conversations between the borrower and a tenant regarding unauthorized assistance received by a tenant.

(e) When a tenant, who has received unauthorized assistance due to tenant error or fraud as determined by the Agency, moves out of a housing project, the borrower is no longer responsible for recapturing the unauthorized assistance provided that the borrower notifies the Agency of the tenant's move and transfers all records related to the tenant's unauthorized assistance to the Agency within 30 days of the tenant's move. The Agency will pursue collection of the unauthorized assistance from the tenant.

(f) If a borrower refuses to enter into an unauthorized assistance repayment schedule with the Agency, the Agency will initiate liquidation procedures, in accordance with § 3560.456, or other enforcement actions, such as suspension, debarment, civil, or criminal penalties, in accordance with § 3560.461. If a tenant refuses to enter into an unauthorized assistance repayment schedule, the Agency will initiate recovery actions against the tenant.

(g) Borrowers may not use housing project funds to pay amounts due to the Agency as a result of unauthorized assistance due to borrower fraud.

#### § 3560.706 Offsets.

Offsets and any other available remedies may be used by the Agency to recapture unauthorized assistance. Guidance concerning use of offsets can be found at 7 CFR 3550.210.

#### § 3560.707 Program participation and corrective actions.

(a) With Agency approval, a borrower or tenant, who has received unauthorized assistance, may continue to participate in the project if they have the legal and financial capabilities to do so. Approval considerations for such forbearance and repayment are in § 3560.705.

(b) A borrower or tenant who was responsible for the circumstances causing the unauthorized assistance must take appropriate action to correct the problem within 90 days of the unauthorized assistance determination notice date, unless an alternative date is agreed to by the Agency.

(c) When the interest rate shown in a debt instrument resulted in the receipt of unauthorized assistance, the debt instrument will be modified to the correct interest rate. All payments made

by the borrower at the incorrect interest rate will be reapplied at the correct interest rate, and remaining payments due on the loan will be recalculated on the basis of the correct interest rate, plus any amounts due to the Agency as a result of the use of an incorrect interest rate, unless the Agency agrees to a separate repayment process.

#### § 3560.708 Unauthorized assistance received by tenants.

(a) Tenant actions that require tenant repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Knowingly or mistakenly misrepresenting income, assets, adjustments to income, or household status to the borrower as required under subpart D of this part; or

(2) Failure to properly report changes in income, assets, adjustments to income, or household status to the borrower as required in subpart D of this part.

(b) Borrower actions that require borrower repayment of unauthorized assistance received by tenants include, but are not limited to:

(1) Incorrect determination of tenant income or household status by the borrower, resulting in rental assistance or interest credit that is not allowable under the provisions of subparts D, E, or F of this part, as applicable; or

(2) Assignment of rental assistance to a household that is ineligible under the requirements of subpart F of this part.

(c) When it is determined that a tenant has received unauthorized assistance, the borrower shall notify the tenant and the Agency through the procedure specified in § 3560.704.

(d) Borrowers may not charge tenants to pay amounts due to the Agency as a result of unauthorized assistance to tenants through borrower error.

(e) Borrowers must notify the Agency of all collections from tenants as repayments for unauthorized assistance and must remit or credit the amounts collected to applicable housing project accounts.

(f) When rental assistance was improperly assigned to a tenant, for any reason, the rental assistance benefit must be canceled and reassigned.

(1) Before a borrower notifies a tenant of rental assistance cancellation, the borrower must request Agency approval. If the Agency determines that the unauthorized rental assistance was received by the tenant due to borrower fraud or error, the borrower must give the tenant 30 days notice, in writing, that the unit was assigned in error and that the rental assistance benefit will be canceled effective on date that the next

monthly rental payment is due after the end of the 30-day notice period.

(2) Tenants also must be notified, in writing, that they may cancel their lease without penalty at the time the rental assistance is canceled. Tenants must be offered an opportunity to meet with a borrower to discuss the rental assistance cancellation.

#### § 3560.709 Demand letter.

(a) If a borrower fails to respond to an unauthorized assistance determination notice or fails to agree to a repayment schedule, the Agency will send the borrower a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination; and

(2) The actions to be taken by the Agency if repayment is not made by a specified date.

(b) If a tenant fails to respond to the unauthorized assistance determination notice or fails to agree to a repayment schedule, the borrower will send the tenant a demand letter specifying:

(1) The amount of unauthorized assistance to be repaid and the basis for the unauthorized assistance determination;

(2) The actions to be taken if repayment is not made by a specified date, including termination of tenancy; and

(3) The appeal rights of the tenant as specified in § 3560.160.

(c) A demand letter may be sent to a borrower or tenant, in lieu of an unauthorized assistance determination notice, when the evidence documenting the unauthorized assistance determination is deemed to be conclusive by the Agency or borrower sending the letter.

#### §§ 3560.710–3560.749 [Reserved]

#### § 3560.750 OMB control number.

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response, including time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. A person is not required to respond to a collection of information unless it displays a currently valid OMB control number.

**Subpart P—Appraisals****§ 3560.751 General.**

This subpart sets forth appraisal policies for Agency-financed multi-family housing (MFH) projects consisting of five or more rental units. Agency-financed housing projects with fewer than five rental units may be appraised in accordance with the Agency's single family housing appraisal policies established under 7 CFR 3550.62.

**§ 3560.752 Appraisal use, request, review, and release.**

(a) *Appraisal uses.* The Agency will use appraisals to determine whether the security offered by an applicant or borrower is adequate to secure a loan or determine appropriate servicing or preservation decisions. Appraisals used for Agency decision-making must be current, unless the Agency and the applicant, or borrower, mutually agree to the use of an appraisal that is not current. A current appraisal is an appraisal with a report date that is not more than one year old.

(b) *Appraisal requests.* Appraisal requests must be in writing and must specify the client and other intended users, the intended use, the purpose, and the scope of work of the appraisal, including the type and definition of the value(s) to be developed.

(1) *Type of Value.* The appraisal request must indicate whether the "market value", the "market value, subject to restricted rents", or any other type of value of the housing project and related facilities is to be concluded.

(i) A request for "market value, subject to restricted rents" means the appraisal will take into consideration any rent limits, rent subsidies, expense abatements, or restrictive-use conditions that will affect the property as a result of an agreement with the Agency or any other financing source. Each type of financing involved, including, but not limited to, interest credit subsidy, low-interest loans from other sources, tax-exempt bond financing, tax credits, and grants, must be valued separately in the appraisal.

(ii) A request for "market value" means the appraisal will take into consideration the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

(A) Buyer and seller are typically motivated;

(B) Both parties are well informed or well advised and acting in what they consider their best interests;

(C) A reasonable time is allowed for exposure in the open market;

(D) Payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and

(E) The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

(2) "'As-is' Value" or "Prospective Value". The appraisal request must indicate whether the "'as-is' value" or "prospective value" of the housing is to be concluded.

(i) "'As-is' value" means the value of the housing and related facilities as of the effective date of the appraisal. It relates to what physically exists and is legally permissible at the time of the appraisal and excludes all hypothetical conditions.

(ii) "Prospective value" means the forecasted value of the housing and related facilities as of a specified future date. For Agency appraisals, this date will typically be the projected completion date of proposed new construction or rehabilitation.

(3) *Section 8 project-based assistance.* Depending on the intended use of the appraisal, the Agency will specify whether or not section 8 project-based assistance will be considered in the valuation of the housing. The remaining term of the section 8 contract and the probability of subsequent renewal terms being authorized will be taken into consideration when making this determination.

(4) *Low-Income Housing Tax Credit (LIHTC) and other financing sources.* Depending on the intended use of the appraisal, the Agency will specify whether or not tax credits and other financing sources involved in the housing will be considered in the valuation of the housing.

(c) *Appraisal review.* All MFH appraisals that were not written by an Agency appraiser will be reviewed by an Agency appraiser, who will write and file a technical review report that complies with the Uniform Standards of Professional Appraisal Practice (USPAP) and Agency requirements.

(d) *Release of appraisals.* MFH appraisals procured by the Agency will be released to owners/applicants, from their own files, upon their request.

**§ 3560.753 Agency appraisal standards and requirements.**

(a) *General.* The Agency recognizes USPAP as the basic standards for appraisals. Appraisals used by the Agency must comply with USPAP and this subpart.

(b) *Appraisers.* MFH appraisals prepared for the Agency will be written by Agency appraisers or independent fee appraisers who are state certified general appraisers, certified in the state where the property is located. Technical review reports will be written by Agency state certified general appraisers.

(c) *Appraisal report.* The appraisal report format may be a form appraisal or a narrative appraisal. The Agency will specify the appraisal format that is most appropriate for the scope of work involved when the appraisal is requested.

(1) *Form appraisal reports.* The Agency will accept appraisal report forms that meet generally accepted industry standards, comply with USPAP, and have been approved by the Agency.

(2) *Narrative appraisal reports.* Narrative appraisal reports must, at a minimum, contain the following items:

- (i) Transmittal letter;
- (ii) Factual information about the property;
- (iii) Regional and neighborhood data;
- (iv) Description of the subject property;
- (v) Description of existing and planned improvements;
- (vi) A highest and best use analysis;
- (vii) A statement regarding any environmental issues, such as potential contamination of the property from hazardous substances, hazardous wastes, or petroleum products;
- (viii) A cost approach analysis (if applicable);
- (ix) A sales comparison approach analysis (if applicable);
- (x) An income approach analysis (if applicable);
- (xi) A reconciliation of the value indications derived from the included approaches to value; and
- (xii) A signed and dated certification of value.

(3) At the time an appraisal is requested, the Agency will specify either a complete or a limited appraisal and one of the following types of appraisal reports, based upon the complexity of the appraisal assignment.

(i) A self-contained report that comprehensively describes all information significant to the solution of the appraisal problem;

(ii) A summary report that summarizes all information significant

to the solution of the appraisal problem; or

(iii) A restricted use report, intended for Agency use only, that briefly states all information significant to the solution of the appraisal problem.

(d) *Highest and best use statement and analysis.* The highest and best use is to be concluded for the subject site as though it was vacant, and for the subject property as improved, if improvements have been made. If the highest and best use of a subject property is for something other than MFH, the appraisal report must provide this information to the Agency for consideration in the loan process. In addition to being reasonably probable and appropriately supported, the highest and best use of both the land as though vacant and the property as improved must meet four implicit criteria. The highest and best use must be:

- (1) Physically possible;
- (2) Legally permissible;
- (3) Financially feasible; and
- (4) Maximally productive.

(e) *Valuation methods and variances.* The final opinion of value presented in an appraisal report must have considered a cost approach, a sales comparison approach, and an income approach. If one of these standard approaches is not used, the reconciliation narrative will provide a full and complete explanation of the reasons the approach was excluded. The reconciliation will fully discuss and reconcile variances in the value indications concluded by each approach.

(f) *Real estate history.* Appraisals must contain a 5-year ownership and sales history for the housing project being appraised.

(g) *Reserve accounts.* Funds in the housing project's reserve account will not be considered in the valuation of the housing project.

(h) *Escrow accounts.* Short-term prepaid escrow accounts for general operating expenses, such as taxes and insurance, shall not be considered in the valuation of the housing project.

(i) *Rental rates comparison.* The appraisal report must document whether the housing project's basic rents are less than, equal to, or greater than market rents for comparable conventional, or non-subsidized, units in the area where the housing is located.

(j) *Description of housing and property rights.* The appraisal report must identify and describe both the real estate, which is the land and improvements, and the real property, or property rights, being appraised.

(k) *Exclusion of rental units from valuation.* The Agency will provide appraisers with instructions and supporting information on any rental units that do not produce rental income at the time of the appraisal.

(l) *Non-contiguous sites.* When a housing project has real property located on non-contiguous sites, a separate appraisal must be developed for each site.

**§§ 3560.754–3560.799 [Reserved]**

**§ 3560.800 OMB control number.**

The information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) and have been assigned OMB control number 0575–0189. Public reporting burden for this collection of information is estimated to vary from 15 minutes to 18 hours per response,

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**PART 3565—GUARANTEED RURAL RENTAL HOUSING PROGRAM**

■ 62. The authority citation for part 3565 continues to read as follows:

**Authority:** 5 U.S.C. 301; 7 U.S.C. 1989; 42 U.S.C. 1480.

**Subpart E—Loan Requirements**

**§ 3565.204 [Amended]**

■ 63. Section 3565.204 is amended in paragraph (c)(2) by removing the words “part 1944, subpart E” and by adding in its place the word “3560.63 (d).”

**Subpart H—Project Management**

**§ 3565.351 [Amended]**

■ 64. Section 3565.351 is amended in paragraph (c) by removing the words “part 1944, subpart L” and by adding in their place the words “part 3560, subpart D.”

Dated: November 12, 2004.

**Gilbert Gonzalez,**

*Acting Under Secretary, Rural Development.*

Dated: November 12, 2004.

**J.B. Penn,**

*Under Secretary, Farm and Foreign Agricultural Services.*

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