

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 401 and 402

[Docket No. FR-4298-I-01]

RIN 2502-AH09

Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-to-Market) and Renewal of Expiring Section 8 Project-Based Assistance Contracts

AGENCY: Office of the Secretary, HUD.

ACTION: Interim rule.

SUMMARY: This interim rule implements recently-enacted legislation that created a Mark-to-Market Program through which section 8 rents for multifamily projects with HUD-insured or HUD-held mortgages will be reduced. The purpose of the program is to preserve low-income rental housing affordability while reducing the long-term costs of Federal rental assistance, including project-based assistance, and minimizing the adverse effect on the FHA insurance funds. The Mark-to-Market Program will be implemented through Mortgage Restructuring and Rental Assistance Sufficiency Plans to be developed for individual projects by Participating Administrative Entities selected by HUD. The interim rule also implements legislation for renewal of section 8 project-based assistance contracts for projects outside of the Mark-to-Market Program.

DATES: *Effective Date:* October 13, 1998.

Comment Due Date: October 26, 1998.

ADDRESSES: Interested persons are invited to submit comments regarding this interim rule to the Office of the General Counsel, Rules Docket Clerk, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, DC 20410. Communications should refer to the above docket number and title. A copy of each communication submitted will be available for public inspection and copying during regular business hours (7:30 a.m.-5:30 p.m. eastern time) at the above address. HUD will not accept comments sent by facsimile (FAX). (In addition, see the Paperwork Reduction Act heading under the Findings and Certifications section of this preamble regarding submission of comments on the information collection burden.) See **SUPPLEMENTARY INFORMATION** section for electronic access and filing information.

FOR FURTHER INFORMATION CONTACT: Dan Sullivan, Department of Housing and Urban Development, 451 7th St., Washington DC 20410. Telephone: 202-

708-0547. (This is not a toll-free number.) For hearing- and speech-impaired persons, this number may be accessed via TTY by calling the Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutes

The Multifamily Assisted Housing Reform and Affordability Act of 1997, title V of Pub. L. 105-65 (approved October 27, 1997), 42 U.S.C. 1437f note (MAHRA), was enacted to reduce the cost of Federal housing assistance, enhance HUD's administration of such assistance, and to ensure the continued affordability of units in certain multifamily housing projects. The projects involved are projects with: (1) HUD-insured or HUD-held mortgages; and (2) contracts for project-based rental assistance from HUD, primarily through the section 8 program, for which the average rents for assisted units exceed the rent of comparable properties. MAHRA authorizes a new Mark-to-Market Program designed to preserve low-income rental housing affordability while reducing the long-term costs of Federal rental assistance, including project-based assistance from HUD. This will be accomplished by (1) reducing project rents to no more than comparable market rents (with certain exceptions discussed below), (2) restructuring the HUD-insured or HUD-held financing so that the monthly payments on the first mortgage can be paid from the reduced rental levels, (3) performing any needed rehabilitation of the project, and (4) ensuring competent management of the project. The project will be subject to long-term use affordability restrictions.

MAHRA is intended to provide a long-term solution to the rapidly growing cost to the Federal Government of assisting affordable rental housing. Over 800,000 housing units in approximately 8,500 multifamily projects have been financed with FHA-insured mortgages and supported by project-based section 8 housing assistance payment (HAP) contracts. In many cases, these HAP contracts currently provide for rents for assisted units which substantially exceed the rents for comparable unassisted units in the local market. Starting in Fiscal Year 1996, those contracts began to expire, and Congress and the Administration have been providing one-year extensions of expiring contracts. While annual HAP contract extensions for these projects maintain an important housing resource, they come at great

expense. Every year more contracts expired, compounding the cost of annual extensions. In 1996, HUD estimated that in 10 years the annual cost of renewing the contracts on current terms would rise to approximately \$7 billion, or one-third of HUD's budget. If the section 8 assistance were simply reduced or eliminated, there would be an increased likelihood that these projects would be unable to meet their financial obligations including operating expenses, current and future capital needs, and debt service payments on FHA-insured or HUD-held mortgages.

To begin to address this growing problem, Congress authorized demonstration programs. The initial demonstration (the 1996 demonstration) was authorized by section 210 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1996, as a demonstration for Fiscal Years 1996 and 1997 for 15,000 units in projects with insured mortgages and section 8 contracts with rents in excess of fair market rents. Section 210 authorized HUD to designate third parties to act on its behalf in connection with the demonstration. The Department published notices regarding the 1996 demonstration at 61 FR 34664 (July 2, 1996) and 61 FR 28757 (July 25, 1996).

Congress repealed the 1996 demonstration authority and replaced it with the demonstration authorized by sections 211 and 212 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997 (the 1997 demonstration) for projects with insured mortgages and project-based assistance contracts expiring in Fiscal Year 1997 with aggregate rents in excess of 120 percent of fair market rents (see HUD's Guidelines published at 62 FR 3566, January 23, 1997). The 1997 demonstration was limited to 50,000 units. HUD relied on third-party designees to perform many important functions.

In section 522(b) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1998, Congress extended the 1997 demonstration, without any volume limitation, to projects with contracts expiring in Fiscal Year 1998. The new 1998 demonstration is generally the same as the 1997 demonstration, with certain modifications, and is a transitional program to permit time for HUD to prepare this rule and take other necessary steps to implement a Mark-to-Market Program for projects with above-

market rents and contracts expiring in Fiscal Year 1999 and later (see HUD guidelines at 63 FR 36130, July 1, 1998).

MAHRA builds on the demonstration program with similar objectives and many similar provisions, but also some significant differences. Organizationally, MAHRA establishes a new Office of Multifamily Housing Assistance Restructuring (OMHAR) within HUD to develop and actively manage, administer, and oversee the Mark-to-Market Program through a decentralized structure of Participating Administrative Entities (PAEs). OMHAR will establish the framework of the Program through regulations and will manage the program by selecting and monitoring Participating Administrative Entities (PAEs). In recognition of limited HUD resources, MAHRA gives PAEs the role of negotiating with the owners of individual projects and developing the Mortgage Restructuring and Rental Sufficiency Plans ("Restructuring Plans") that will establish the future responsibilities of the owner, the PAE and HUD for projects that are marked-to-market. PAEs will be State housing finance agencies or local housing agencies, or nonprofit or for-profit entities in partnership with public entities. OMHAR may itself act as the PAE with respect to selected projects. OMHAR will prescribe the specific responsibilities of each PAE in Portfolio Restructuring Agreements to be negotiated.

MAHRA also contains substantive differences from the previous demonstrations. For example, it includes projects with HUD-held mortgages in addition to HUD-insured mortgages and requires (as does the 1998 demonstration) a second mortgage with deferred payment from net cash flow after accounting for all project expenses.

Section 524 of MAHRA authorizes renewal of section 8 project-based assistance contracts for projects without Restructuring Plans under the Mark-to-Market Program, including renewals that are not eligible for Plans and those for which the owner do not request Plans. Renewals must be at rents not exceeding comparable market rents except for certain exception projects.

B. Current Implementation of MAHRA

While determining the best way to implement MAHRA, HUD sought ideas from a wide variety of non-proprietary, nationally-based organizations with diverse viewpoints and interests. HUD received many "concept papers" from these organizations presenting many different perspectives of which HUD needed to be aware. These concept

papers do not represent HUD policy or any official advisory committee, but were useful in helping to focus HUD's attention on the most important issues to be decided in development of the Mark-to-Market Program. The concept papers are available to the public on the Mark-to-Market Internet web site identified below.

In February 1998, after review of the concept papers, HUD officials attended a series of meeting where they heard the views from members of a working group representing the organizations that had developed the concept papers. Although none of this interim rule is the product of the working group members, the views expressed to HUD were of great benefit in ensuring that HUD was exposed to the widest possible variety of viewpoints on issues and concerns of those to be affected by the Mark-to-Market Program. Notes from these working group sessions are also available on the web site.

HUD is drafting a Program Manual to give program participants operational guidance to supplement this interim rule and the final rule. The Manual will be made publicly available as soon as it is completed. This interim rule will take effect 30 days after publication and commenters should not delay submitting comments in anticipation of any additional material that may be in the Manual.

HUD has taken two other steps toward preliminary implementation of the Mark-to-Market Program. As part of HUD's "SuperNOFA" for Economic Development and Empowerment Program published on April 30, 1998 in the **Federal Register** (63 FR 23876), HUD announced the availability of funding for Intermediary Technical Assistance Grants (ITAG) and Outreach and Training Grants (OTAG). These programs will assist tenant and local community groups, State and local governments, and other groups with funding for technical assistance so they can participate meaningfully in the Mark-to-Market Program. State-or community-wide nonprofit or public entity intermediaries to distribute these funds are selected competitively.

HUD has also issued a Request for Qualifications (RFQ) for eligible entities interested in being Participating Administrative Entities, 63 FR 44102, August 17, 1998. When this interim rule takes effect, HUD expects to have made substantial progress toward having a PAE infrastructure in place and will begin assigning assets (eligible projects with expiring section 8 contracts) as soon as each PAE executes its Project Restructuring Agreement (PRA) with

HUD. HUD will provide training for PAEs.

Beginning in October 1998, HUD also expects to begin extending, on an interim basis as provided in the rule, contracts expiring in Fiscal Year 1999 for eligible projects pending either development of requested Restructuring Plans or full review of requests for renewal under section 524 of MAHRA.

On July 21, 1998, the Treasury Department issued Revenue Ruling 98-34 clarifying the tax impact of the mortgage restructuring required for the Mark-to-Market Program. This ruling (published in 1998-31 I.R.B. at page 12, August 3, 1998) reduces uncertainty and is expected to mitigate many concerns of owners who are eligible to participate in the Mark-to-Market Program.

MAHRA provides that before publication of final regulations HUD is to conduct at least three public forums at which organizations representing various groups identified in MAHRA may express views concerning HUD's proposed disposition of recommendations from those groups. The Department expects to conduct these forums within several weeks after publication of this interim rule, with tentative locations in New York, Chicago, and San Francisco. The exact location and date, and an information contact, will be posted on the Mark-to-Market web site (see below).

HUD will make additional information on the Mark-to-Market Program available on HUD's Internet web site, currently at <http://www.hud.gov/fha/mfh/pre/premenu.html>. Among other information, HUD will provide a list of addresses of HUD HUBs that have jurisdiction over the Program, a list of PAEs that have been selected, and a list of potentially-eligible projects.

MAHRA directs HUD to issue this interim rule, which (in addition to MAHRA) will serve as the legal authority for the Mark-to-Market Program and for extension of expiring section 8 project-based contracts until OMHAR issues the required final rule. HUD will not process contract renewals under this rule until October 1, 1998. HUD intends to issue one or more Notices with additional information on contract renewal procedures. OMHAR will develop and issue a final rule as required by MAHRA as soon as feasible after it has considered the public comments to be submitted regarding this interim rule. The Program will operate based on this interim rule until the final rule takes effect.

II. Content of Part 401

Two new parts are added to title 24 of the Code of Federal Regulations. Part 401 covers the new Mark-to-Market Program including renewals of section 8 contracts under the Program. Part 401 also covers the determination of whether an eligible project will be given a contract renewal without a Restructuring Plan. Part 402 covers section 8 contract renewals without a Restructuring Plan (i.e., outside of the Mark-to-Market Program).

Part 401 is divided into the following subparts:

- Subpart A—General Provisions; Eligibility
- Subpart B—Participating Administrative Entity (PAE) and Portfolio Restructuring Agreement (PRA)
- Subpart C—Restructuring Plan
- Subpart D—Implementation of the Restructuring Plan after Closing
- Subpart E—Section 8 Requirements for Restructured Projects
- Subpart F—Owner Dispute of Rejection and Administrative Appeal

Specific sections in these subparts are discussed below under the section headings.

Subpart A—General Provisions; Eligibility

Section 401.1 What is the Purpose of Part 401?

Section 401.1 explains that part 401 contains the regulations implementing the Mark-to-Market legislation, including the renewal of section 8 assistance for restructured projects. The section references sections 511(b) and 512(2) of MAHRA which detail the purpose and scope of the Mark-to-Market Program. In general, the Program is intended to enhance HUD's administration and oversight of projects with section 8 assisted housing through delegation of certain functions to State housing finance agencies and local housing agencies and other nonprofit and for-entities as Participating Administrative Entities (PAEs). Pursuant to Portfolio Restructuring Agreements (PRAs), PAEs will develop Restructuring Plans for assigned projects to ensure continued availability of affordable multifamily housing through reduction of rents, restructuring of mortgage obligations if required, needed rehabilitation, and assurance of competent management, with the objective of reducing the long-term costs to the Government for such housing and minimizing the adverse effect on the FHA insurance funds. The Program includes projects with HUD-insured and HUD-held mortgages, HUD-provided project-based rental assistance contracts that expire on October 1, 1998 or later,

and rents that are above comparable market rents (eligible projects) subject to exceptions described in § 401.100.

Section 401.2 What Special Definitions Apply to This Part?

Section 401.2 identifies the statute (MAHRA) which created the Mark-to-Market program. It also identifies the terms that are defined in MAHRA and used in the rule, and defines the following additional terms that are used in the rule: affiliate, applicable Federal rate, community-based nonprofit organization, comparable market rents, disabled family, elderly family, eligible project, HUD, NHA, owner, PAE, PCA, PRA, priority purchaser, Rental Assistance Assessment Plan, Restructured Rent, Restructuring Plan, section 541(b) claim, section 8, tenant organization, and unit of local government. In the definition of HUD, it is explained that HUD means the Director of OMHAR for matters that MAHRA specifically assigns to OMHAR. Otherwise, HUD means the Department of Housing and Urban Development generally, acting through the Secretary and other responsible organizations and officials of the Department. FHA mortgage insurance matters are the responsibility of the Assistant Secretary for Housing-Federal Housing Commissioner, who is also responsible for most section 8 project-based assistance. The Assistant Secretary for Public and Indian Housing is responsible for project-based moderate rehabilitation contracts and for tenant-based assistance (vouchers and certificates). HUD's new Real Estate Assessment Center and Enforcement Center are also likely to have a role in carrying out some HUD functions under the rule. The rule does not attempt to sort out these responsibilities within HUD, which are covered by internal delegations of authority.

Section 401.99 What Actions Must an Owner Take to Request a Section 8 Contract Renewal?

Section 401.99 explains three procedures to be followed by owners who request renewals of section 8 project-based assistance contracts. If the owner of an eligible project requests a Restructuring Plan the owner must, at least 3 months before the project-based assistance contract expires (or as soon as practicable if the contract will expire less than 3 months after the effective date of this interim rule), certify to HUD that, to the best of the owner's knowledge, project rents exceed comparable market rents and neither the owner nor any affiliate is suspended or debarred (or that the owner proposes a

voluntary sale of the project). HUD will assign the project to a PAE which will contact the owner. The owner will submit an application to the PAE with the information necessary to enable the PAE to begin development of a Restructuring Plan. The owner must also contact the mortgagee to determine the mortgagee's willingness to consider a modification of the first mortgage as part of the Restructuring Plan. Both the owner and the mortgagee are expected to cooperate with the PAE in the development of the Plan, as provided in § 401.402. The PAE will perform an underwriting analysis. After development of a Restructuring Plan and mutual execution of a Restructuring Commitment, the PAE will coordinate the closing using standard form documents (which will be made available to the owner for review at the beginning of the restructuring process.)

If the owner of an eligible project does not request a Restructuring Plan, the owner must submit to HUD the certification described above in the same time frame with the following additional items: a comparable market rent analysis indicating that the rents are above comparable market rents (using the approach described in § 401.410); the prior fiscal year's annual audited financial statement for the project; and the owner's evaluation of the physical condition of the project. The request will be considered in accordance with § 401.601. Finally, because part 401 is limited to projects eligible for a Restructuring Plan, this section refers the owner to § 402.5 if the project is not eligible for restructuring but the owner wants project-based assistance renewed.

Section 401.100 Which Projects are Eligible for a Restructuring Plan Under This Part?

Section 401.100 incorporates the statutory requirements in section 512(2) of MAHRA for an eligible project. The section explains that project rent exceeds the rent of comparable properties, as required by section 512(2)(A), if the gross potential rent revenue (i.e., at 100 percent occupancy) for the project-based assisted units in the project at current gross rents exceeds the gross potential rent for those units (at 100 percent occupancy) using comparable market rents.

Section 401.100 excludes projects identified in section 514(h) of MAHRA: (1) projects with primary financing or mortgage insurance from State or local governments or their agencies or instrumentalities; (2) projects for the elderly financed under the HUD section 202 program or the Department of

Agriculture's section 515 program; or (3) projects with section 8 moderate rehabilitation contracts for single room occupancy dwellings.

Because of the express prohibition in section 514(h)(1) of MAHRA, under current law the interim rule does not permit a Restructuring Plan for any project with State or local government primary financing. HUD is aware that Congress is considering amendment of section 514(h) to exclude only those projects with State or local primary financing that are identified in section 524(a)(2)(B) of MAHRA. If the law is so amended, the effect of that change would be automatically reflected in this section without the need for revision.

Section 401.101 Which Owners Are Ineligible for a Restructuring Plan?

Section 401.101 states that an owner's request for a Restructuring Plan will not be considered if the owner or an affiliate is debarred or suspended, unless a sale or transfer is proposed. (Section 401.480 discusses project sales or transfers.) The owner may follow the dispute and administrative appeal procedures in subpart F. The owner may dispute whether there is debarment or suspension, under procedures set forth in § 401.645, but may not reopen the question of whether a debarment or suspension was properly imposed. The owner's request may also be rejected later as provided in § 401.403.

Subpart B—Participating Administrative Entity (PAE) and Portfolio Restructuring Agreement (PRA)

Except for situations when HUD will itself undertake the functions of the PAE for a project due to lack of any other qualified PAE, HUD will select a PAE and enter into a Portfolio Restructuring Agreement with the PAE. The PAE obtains the necessary information about the project that will enable it to develop a viable Restructuring Plan for ensuring that the goals of MAHRA are met for a project, and becomes responsible for ensuring implementation of the Plan after HUD approval. The PAE maintains communications with all affected parties including the owner, tenants, the community, and HUD. The specific role of each PAE will be detailed in its PRA with HUD. HUD's Program Manual will contain detailed guidance on the information collection process, including the information needed and the respective roles of the PAE, owner, mortgagee/servicer and others.

Section 401.200 Who May Be a PAE?

Section 512(10) of MAHRA permits a public agency (including a State

housing finance agency or a local housing agency), a nonprofit organization, or a for-profit entity, to act as a PAE. The PAE may not have any outstanding violations of civil rights laws, determined in accordance with criteria in use by HUD. Section 513(b)(7)(A) of MAHRA requires that any for-profit entity serving as a PAE do so in partnership with a public entity, which may include HUD. Section 513(b)(6)(B) of MAHRA requires the prior approval of HUD for any delegation or transfer of responsibilities by a State housing finance agency or a local housing agency. Section 401.200 of the rule includes all of these provisions, with the additional requirements that a nonprofit PAE also partner with a public purpose entity and that all delegations be approved by HUD in the PRA. This section also clarifies that a partnership must meet all legal requirements for a partnership.

Section 401.201 How Does HUD Select PAEs?

Section 401.201 explains that HUD will select PAEs in accordance with the statutory selection criteria and additional selection criteria established by HUD. The selection method will be determined by HUD, and may be through a request for qualifications (RFQ). As discussed in Part I of this Supplementary Information, HUD's initial selections will be through an RFQ.

The rule gives a one-time priority to qualified State housing finance agencies and local housing agencies by giving them exclusive consideration for an initial period after HUD has received responses to the initial RFQ. During the initial period, HUD will consider other entities as PAEs only to the extent that HUD has been unable to identify qualified State housing finance agencies or local housing agencies who are interested in serving as PAEs, or that projects have not been assigned to a qualified agency. If more than one qualified agency responding to the initial RFQ expresses interest for projects in the same jurisdiction, HUD will provide the responding agencies an opportunity to agree on an allocation of responsibility between themselves before HUD will make a selection in accordance with section 513(b)(2) of MAHRA. If no PAE is selected for a project in the Mark-to-Market program due to lack of qualified interested entities, HUD will itself serve as PAE.

Section 401.300 What Is a PRA?

In accordance with section 513(a)(2) of MAHRA, § 401.300 describes the PRA as an agreement between HUD and the

PAE to define their respective rights and responsibilities in connection with development and implementation of Restructuring Plans. The PRA must contain the matters required by section 513(a)(2) of MAHRA. The following sections in this subpart B explain some of the statutory requirements for a PRA and other requirements of HUD.

Section 401.301 Business Arrangements

Section 401.301 lists some of the basic elements regarding business arrangements under the PRA. The PRA must specify: (a) the responsibilities of each partner of the PAE in carrying out the PRA; (b) the resources each partner will provide to accomplish its responsibilities; and (c) all compensation to each partner, direct or indirect.

Section 401.302 PRA Administrative Requirements

Section 513(a)(2)(A) of MAHRA characterizes the PRA as a "cooperative agreement". Generally, a cooperative agreement is used when

(1) The principal purpose of the relationship is to transfer a thing of value to the State, local government, or other recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring (by purchase, lease, or barter) property or services for the direct benefit or use of the United States Government; and

(2) Substantial involvement is expected between the executive agency and the State, local government, or other recipient when carrying out the activity contemplated in the agreement.

(31 U.S.C. 6306.) HUD has concluded that Congress did not intend the PRA to be a "cooperative agreement" within this strict definition so that certain legal provisions that ordinarily apply to such cooperative agreements are not directly applicable to PRAs. The primary purpose of the PAE lies not in using public funds to carry out the purposes of MAHRA, but in enlisting the resources and expertise that Congress felt were lacking at HUD. At the same time, the PAE is not a mere provider of services to HUD. It is performing an independent, statutorily-defined role. It appears that Congress used the term "cooperative agreement" in a general sense to emphasize that HUD was not simply procuring the services of a PAE, nor making a grant to a PAE, but that HUD should not otherwise be constrained by the ordinary consequences of designating a legal instrument as a cooperative agreement.

MAHRA itself is very specific on the purpose and contents of a Portfolio Restructuring Agreement and the unique relationship that it creates. Thus, HUD has concluded that it would be inappropriate to subject a PRA to 24 CFR parts 84 ("Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-profit Organizations") and 85 ("Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally-Recognized Indian Tribal Governments"). Similarly, the PRA is not subject to procurement contract requirements.

All PAEs are subject to recordkeeping and inspection and audit of records as provided in this section. Reporting requirements for the PAE will be contained in the PRA.

Section 401.303 PRA Indemnity Provisions for SHFAs and HAS

Section 401.303 implements section 513(a)(2)(G) of MAHRA, which requires the PRA to provide that HUD indemnify a PAE against lawsuits and penalties for action taken pursuant to the PRA (except for willful misconduct or negligence), but only if the PAE is a State housing finance agency or a local housing agency. HUD interprets the statutory indemnification as extending only to agencies that are named as the PAE in the PRA, and not to agencies that may have partnered with another public or private entity that is named as the PAE. The indemnification also does not extend to partners of agencies named as PAEs, even if the partners are agencies that would receive indemnification if named in the PRA as PAE. Section 401.303 makes clear that HUD's obligation to indemnify is contingent upon the availability of funds that may legally be used for this purpose.

Section 401.304 PRA Provisions on PAE Compensation

Section 401.304 provides that the PRA will contain provisions on compensation to the PAE regarding a base fee and reimbursement of expenses, and may provide for incentive fees. The function of the PAE is a unique one for which there is little experience in determining appropriate fees that will both attract competent entities and result in cost-effective performance. In the interim rule, HUD is deferring setting any limits on the actual amount or method of calculation of the base fee and incentive fee. The RFQ for prospective PAEs asks them to provide an estimate of the required fee. As a result of reviewing this information, negotiating the actual fee

arrangements for initial PAEs and refining the precise duties of PAEs in the initial PRA development process, and considering the information and ideas received through the public comment process on the interim rule, HUD intends to include in the final rule more specific provisions on the amount and method of calculation of the base fee and incentive fee. Fees may be different for the public body PAEs selected in "Phase I" of the RFQ process than for those selected for "Phase II".

Section 401.307 Ongoing Responsibility of PAE

Section 401.307 states that the PRA must provide for ongoing activities necessary to implement the Restructuring Plan. This may be accomplished through later amendments once the Plan is developed.

Section 401.309 PRA Term and Termination Provisions; Other Remedies

The PRA will have a term of 1 year, to be renewed for successive terms of 1 year with the mutual agreement of both parties subsequent to HUD review of performance. The PRA will provide for final compensation to the PAE and allocation of existing responsibilities if the PRA is not renewed. A PRA will be subject to termination by HUD at any time for cause, with any final compensation for matters performed by the PAE to that point to be paid by HUD as provided in the PRA, subject to HUD's right of set-off. If cause for termination exists, HUD may order an immediate transfer of some or all of the PAE's duties to another PAE designated by HUD, with a temporary waiver of termination pending satisfactory completion of an orderly transfer. During the term of a PRA, or notwithstanding any termination of a PRA, HUD may seek its actual, direct, and consequential damages from any PAE failure to comply with its obligations under the PRA. The remedies under § 401.309 are cumulative and in addition to any other remedies or rights HUD may have under the terms of the PRA, at law, or otherwise.

Section 401.310 Conflicts of Interest

Section 401.310 addresses conflicts of interest for a PAE and related persons included in the definition of "restricted person": a management official, controlling party or other party under common control, or employee, agent or contractor of the PAE performing services under the PRA. A conflict of interest exists when a PAE or restricted person either (1) has personal, business,

or financial interests or relationships that would lead a reasonable and knowledgeable person to question the integrity or impartiality of those acting for the PAE; or (2) in a lawsuit, is an adverse party either to HUD or to the owner of a project under the PAE's PRA. In general, HUD will avoid dealing with a PAE with a conflict of interest. The conflict may be eliminated by the PAE, or may be waived by HUD. Waiver will be reserved for situations when HUD's interest in the PAE's participation outweighs the concern that a reasonable person may question the integrity of HUD's operations.

This section sets forth procedures for addressing conflict of interest questions that arise before and after selection of a PAE. Conflicts of interest after selection may, if left uncorrected, lead to declaration of default under the PRA and termination, and other remedies described in § 401.313.

Section 401.311 Standards of Conduct

A PAE and restricted persons are subject to minimum ethical standards set forth in section 401.311. The standards prohibit matters such as solicitation by the PAE of items of value from a person with an interest in the performance of the PAE, improperly using property that is under the PAE's charge because of the PRA, using its status as PAE for the benefit of a third party except as contemplated by the PRA, or making unauthorized commitments on behalf of HUD. Section 401.311 cites relevant criminal provisions of the U.S. Code.

Section 401.312 Confidentiality of Information

Section 401.312 requires the PAE and restricted persons to protect avoid misuse of confidential information.

Section 401.313 Consequences of PAE Violations; Finality of HUD Decision

Section 401.313 makes clear the severe consequences that may follow from violation by a PAE or restricted persons of §§ 401.310-.312. As appropriate, HUD may declare a PAE in default under an existing PRA, terminate a PRA under the termination-for-cause provision of § 401.309(b), remove a PAE's eligibility for award of a PRA or to receive projects for restructuring, become liable for damages to HUD arising from termination, or exercise any other rights HUD may have. A HUD decision is final with no further administrative review available.

Section 401.314 Environmental Review Responsibilities

Section 401.314 states that HUD is legally required to retain any environmental review responsibilities under 24 CFR part 50, and that any required environmental review will occur before HUD executes a Restructuring Commitment (see § 401.405). Without delegating any decision-making authority to the PAE, HUD may include in the PRA a provision providing for PAE completion of forms/or and checklists to assist HUD in complying with its requirements under environmental regulations.

Subpart C—Restructuring Plan**Section 401.400 Required Elements of a Restructuring Plan**

Section 401.400 provides overall guidance on what a Restructuring Plan must contain. A Restructuring Plan is required for each project undergoing restructuring under the Mark-to-Market Program. The PAE develops the Plan. Subpart C provides detailed guidance for major elements of a Restructuring Plan in addition to those specifically mentioned in MAHRA.

Section 401.401 Consolidated Plans

Section 401.401 describes the circumstances under which HUD may consider a Consolidated Restructuring Plan for multiple projects.

Section 401.402 Cooperation with Owner and Qualified Mortgagee in Restructuring Plan Development

Section 401.402 provides guidance for implementation of the requirement in section 514(a)(2) of MAHRA for PAE cooperation with the project owner and qualified mortgagee in development of the Restructuring Plan. The owner is expected to submit a proposal to the PAE with the basic elements of a restructuring that the owner finds acceptable. The owner must actively work with the PAE and other necessary third parties to develop that restructuring, if acceptable to the PAE, or a modified or substitute restructuring proposed by the PAE. If the owner fails to cooperate to the satisfaction of the PAE, and HUD agrees, the PAE will refuse to continue with development of a Restructuring Plan. The PAE will ensure that the owner contacts the qualified mortgagee to obtain project history and to explore modification of the existing mortgage if feasible. If the qualified mortgagee does not cooperate in modifying the mortgage, the PAE and the owner may continue to develop a Plan to restructure the loan using alternative financing.

Section 401.403 Rejection of a Request for a Restructuring Plan Because of Actions or Omissions of the Owner or Affiliate or Project Condition

Section 401.403 implements part of section 516(a) of MAHRA. (Section 516(a) is also implemented by §§ 401.101 and 402.7.) Under § 401.403, the PAE is responsible for a further more complete and ongoing assessment of owner and project eligibility while a Restructuring Plan is developed. The PAE must advise HUD, and may elect not to continue with consideration of the Restructuring Plan or the closing on the Plan (see § 401.407), if at any time any of the following conditions exist: (1) the owner or an affiliate is debarred or suspended; (2) the owner or an affiliate has engaged in material adverse financial or managerial actions or omissions as described in section 516(a) of MAHRA, which may include actions that have resulted in imposition of a Limited Denial of Participation (LDP) or a proposed debarment under 24 CFR part 25, or outstanding violations of civil rights laws; or (3) the project does not meet the housing quality standards in § 401.453. HUD may reject an owner's request for a Restructuring Plan for any of these reasons.

An ineligible owner may agree to development of a Restructuring Plan involving sale or transfer of the project. In subpart F, the rule provides a procedure for owner dispute and administrative review of rejection under this section.

Section 401.404 Proposed Restructuring Commitment

Section 401.404 requires the PAE to submit a completed Restructuring Plan and proposed Restructuring Commitment to HUD for its review and approval before delivering it to the project owner. The proposed Commitment will incorporate the Restructuring Plan and include standard terms and the following project-specific information: (1) the lender, loan amount, interest rate and term of mortgages or any unsecured financing for the restructuring and rehabilitation, and any credit enhancement; (2) amount of any payment of a section 541(b) claim by HUD; (3) type of section 8 assistance and the restructured section 8 rents; (4) any required rehabilitation and the source of the owner contribution, and escrow arrangements; (5) the use of project accounts for other than rehabilitation; (6) terms of any sale or transfer of the project; (7) a schedule of sources and uses of funds and project account balances; and (8) other

conditions to the commitment required by HUD.

Section 401.405 Restructuring Commitment Review and Approval by HUD

Section 401.405 provides for HUD to approve the Plan as submitted, require changes as a condition for approval, or reject the Plan. HUD will inform the PAE of the reasons for rejection. The subpart F dispute and appeal procedure will apply. At a minimum, HUD review will address any provisions of the Plan and the proposed Restructuring Commitment involving the disposition of accounts of the Treasury of the United States, in according with various provisions of MAHRA that make clear that HUD retains control of such accounts. HUD review may be either technical or administrative depending on amount of payment of claim, rehabilitation cost and any other pertinent provisions of the PRA.

Section 401.406 Execution of Restructuring Commitment

The PAE will deliver to the owner for execution a proposed Restructuring Commitment as the final element of a HUD-approved Restructuring Plan. If the owner executes the HUD-approved Restructuring Commitment, the PAE will prepare for closing under § 401.407. An owner that does not execute a Restructuring Commitment has 10 days to appeal the terms of the Restructuring Commitment and seek a modification under subpart F.

Section 401.407 Closing Conducted by PAE

Section 401.407 provides that the PAE must arrange for the closing after the owner has executed the Restructuring Commitment. All necessary legal documents will be executed at the closing, using standard legal instruments acceptable to HUD with modifications only as necessary to comply with applicable State or local law or as approved by HUD. If the project will continue to have a mortgage insured or held by HUD, the regulatory agreement between HUD and the owner will be retained and any necessary amendments to reflect the Restructuring Plan will be executed at closing. HUD's Program Manual will provide detailed guidance on how a closing should be conducted and how closing documents should be distributed.

Section 401.408 Affordability and Use Restrictions Required

Section 401.408 implements section 514(e)(6) of MAHRA, which requires the Restructuring Plan to provide for

affordability and use restrictions on the project, for a term of at least 30 years, consistent with the long-term physical and financial viability and character of the project as affordable housing. These affordability restrictions will be reflected in recorded covenants (a Use Agreement) running with the land. The PAE has the discretion to require restrictions for a longer, but not a shorter, period. The project must continue to be used for residential use with no reduction in the number of residential units without HUD approval.

During a period when at least 20 percent of the units in a project receive project-based assistance, the affordability restrictions applicable to such assistance will apply. When the Restructuring Plan provides for continuation of project-based assistance, section 515 of MAHRA requires HUD (directly or through a PAE) to offer to renew or extend expiring contracts, subject to availability of appropriated funds. The owner is required to accept the offers.

At any time when fewer than 20 percent of the units in a project receive project-based assistance, the Use Agreement will require conformance to the rent and the tenant income profile used in the Low Income Housing Tax Credit Program (LIHTC) for any project that is restructured (i.e., either rents set for 20 percent of the units at 30 percent of 50 percent of median income or for 40 percent of the units at 30 percent of 60 percent of median income.) Where the LIHTC rent and income profile is more restrictive than the market rents at the time of restructuring, the underwriting analysis will take this into account. The type and size of units that satisfy the affordability requirements must be comparable to the entire project.

The Use Agreement will specify which interested parties in addition to HUD and the PAE will have rights of enforcement; they may include tenants, tenant organizations, and affected units of local government, but HUD will retain the right to approve amendments to the Use Agreement without requiring the consent of the other parties with enforcement rights. The Use Agreement will contain appropriate financial and other reporting requirements for the owner, as determined by HUD, to ensure that HUD and the PAE have adequate information to enforce compliance with the Agreement.

Section 401.410 Standards for Determining Comparable Market Rents

Section 401.410 provides guidance to the PAE for determining comparable market rents. An owner should also

follow this guidance when making a preliminary determination of eligibility under §§ 401.99(a)(1) and 402.6(b). The PAE uses comparable market rents both for purposes of confirming the eligibility of the project (because it cannot develop a Restructuring Plan for a project at or below comparable market rents) and for purposes of determining the initial rents under a section 8 contract renewal when rents must be reduced to comparable market rents. The determination of whether rents in a project are comparable to market rents considers only the rents for units in the project that receive project-based assistance.

Comparable market rents are defined (based on the definition of "comparable properties" in section 512(1) of MAHRA) as the rents charged for similar multifamily projects in the same market area, where practicable, that (1) are not receiving project-based assistance (for this purpose only, the term includes section 202/811 projects for the elderly and persons with disabilities in addition to the statutory definition) and (2) are determined by the PAE to be similar to the project as to neighborhood (including risk of crime), type of location, access, street appeal, age, property and unit amenities, utilities, and other characteristics including rent control and others considered relevant by the PAE (e.g., the impact of affordability restrictions which could constrain a project's net operating income.) If a project used as a comparable needs rehabilitation to meet the non-luxury standard that a Mark-to-Market project must meet after rehabilitation (see § 401.452), appropriate adjustments should be made. The PAE must define the market broadly enough to include a reasonable number of projects (at least three) that have a high degree of similarity using the factors identified in the rule. If necessary, the PAE should use non-comparable housing stock in the market, with appropriate adjustments, if necessary to identify an adequate number of comparable properties. If this is inadequate, comparable properties outside the market with appropriate adjustments may be considered. The PAE should set comparable market rent at 90 percent of section 8 Fair Market Rents only as a last resort if no meaningful comparison of projects is possible following the guidance in this section.

Section 401.411 Guidelines for Determining Exception Rents

Section 401.411 applies to cases where section 514(g)(2) of MAHRA permits the use of "exception rents" instead of comparable market rents.

Exception rents may be used in the Restructuring Plan only if the PAE has determined that the housing needs of the tenants and the community cannot be adequately addressed through a Restructuring Plan that provides for comparable market rents, and if comparable market rents would provide an income inadequate to operate the project (negative Net Operating Income or NOI projects).

Exception rents are those that exceed rent levels at comparable market rents but that do not exceed 120 percent of the fair market rent for the market area. For up to five percent of the units with contracts expiring in the fiscal year, HUD may waive the 120 percent requirement on a project-by-project basis upon on a PAE documented determination of special need. The PAE's determination of special need must address why the housing needs of the tenants and the community could not be adequately addressed through implementation of the comparable market rent limitation typical of projects undergoing a Restructuring Plan.

The PAE may approve exception rents only for negative NOI projects, which could not support all operating expenses if rents were based on the comparable market rent. In order to receive exception rents, these negative NOI projects must be determined by the PAE to be positive social assets in the community whose operating expense levels and lack of debt service capacity are not a function of bad management. They should be unique, appropriately situated, and affordable housing, with no other comparable housing alternatives available in the submarket. If they were not restructured at exception rents, the outcome would be displacement of those who would experience difficulty in finding comparable housing, such as the elderly, persons with disabilities and large families.

When exception rents are used, the rent is a budget-based rent based on the factors listed in section 514(g)(3) which include debt service (allowed only on the second mortgage under § 401.461 or to support a rehabilitation loan included in the Restructuring Plan), project operating expenses, a PAE-determined allowance for losses due to vacancies and uncollected rents, a PAE-determined allowance for a reasonable rate of return to the owner (which may be established to provide incentive for owners who meet the housing quality standards in § 401.453 and the property management standards in § 401.484), contributions to adequate reserves, and other necessary project operating expenses as determined by the PAE.

For each fiscal year, HUD approval of exception rents is limited to 20 percent of the units with contracts expiring in the fiscal year unless HUD grants a waiver based on a PAE documentation of special need.

Section 401.412 Adjustment of Rents With Operating Cost Adjustment Factor (OCAF)

Section 401.412 explains the adjustment of rents for contract renewals under a Restructuring Plan using an operating cost adjustment factor (OCAF) as required by section 514(e)(2) of MAHRA. The OCAF will be derived from an analysis of the change in operating expenses in various geographic areas, and will be published by HUD annually. An OCAF may be positive or negative. The OCAF methodology for determining adjusted rent levels is also applied to calculation of rent levels outside of Restructuring Plans under §§ 402.4 and 402.5 except when HUD determines to apply budget-based adjustments as permitted by those sections. Under § 401.412, adjusted rent levels are calculated by multiplying an adjusted base rent level for the project by the OCAF. The adjusted base rent level is the difference between the current aggregate project rents and the debt service.

For the section 8 moderate rehabilitation program (other than for single room occupancy dwellings under section 441 of the Stewart B. McKinney Homeless Assistance Act), rents for contracts renewed under § 402.5 will be adjusted by applying an OCAF to the base rent, minus any costs associated with debt service for the cost of property acquisition. The OCAF will be applied to rents for each unit size assisted under the renewal contracts.

Section 401.420 When Must the Restructuring Plan Require Project-based Assistance?

Section 401.420 implements section 515(c)(1) of MAHRA, which provides for mandatory renewal of project-based assistance in a Restructuring Plan for projects in tight rental markets, projects occupied predominantly (at least 50% of units) by elderly or disabled families, and cooperative housing projects. The rule provides that a tight rental market exists when the PAE determines that the market-wide vacancy rate is at or below 6 percent.

Section 401.421 Rental Assistance Assessment Plan

Consistent with section 515(c)(2) of MAHRA, § 401.421 requires the PAE to develop (after consultation with the owner) a Rental Assistance Assessment Plan for any project not covered by

§ 401.420 to determine whether assistance should be renewed for a project as project-based assistance or whether some or all of the assisted units should be converted to tenant-based assistance. Section 515(c)(2)(B) requires an assessment of the impact of converting to tenant-based assistance and the impact of extending project-based assistance on eight specific areas described in section 515(c)(2)(B). The PAE must consider the cost of providing assistance, comparing the applicable payment standard for tenant-based assistance to the project's adjusted rent levels determined under § 401.410 or § 401.411. In addition, the PAE must consider the other matters listed in section 515(c)(2)(B) of MAHRA to be assessed as part of the Plan, and the applicable Consolidated Plan developed under part 91 of this title. In addition to these statutory considerations, § 401.421 requires a PAE to consider the local Consolidated Plan under 24 CFR part 91. The PAE may allow up to 5 years for a conversion to tenant-based assistance if needed for the financial viability of the project. In accordance with section 515(c)(2)(C) of MAHRA, the PAE must report at least semi-annually to HUD on projects for which the Restructuring Plan either: (1) provides for renewal of project-based assistance even though tenants generally supported tenant-based assistance; or (2) provides for renewal with tenant-based assistance.

Section 401.450 Owner Evaluation of Physical Condition

The Restructuring Plan must provide for rehabilitation of the project necessary to achieve the property standards set forth in § 401.452. The first step in developing this part of the Plan is an evaluation by the owner of the physical condition and rehabilitation needs of the project, which is provided to the PAE as part of the PAE's initial data collection for the project. The evaluation must contain the following information:

- (1) All work items needed to bring the project to the property standard in § 401.452, including deferred maintenance and any needed repairs including work items likely to be needed in the next 12 months;
- (2) The capital repair or replacement items that will be necessary to maintain the long-term physical integrity of the property;
- (3) Plans for funding rehabilitation needs under the Restructuring Plan, including the source of required non-project funds to be contributed by the owner; and
- (4) An estimate of the initial deposit, if any, and the estimated monthly

deposit to the reserve for replacement account for the next 20 years.

Section 401.451 PAE Physical Condition Analysis (PCA)

Under § 401.451, the PAE is responsible for an independent evaluation of the rehabilitation needs (a Physical Condition Analysis, or PCA) of the project, and for reviewing and certifying to the accuracy of the owner's evaluation (which may be modified to address deficiencies identified by the PAE.) Both the project's immediate physical condition and rehabilitation needs, and its long term maintenance and replacement needs, must be evaluated and addressed in the PAE's review. The owner must immediately complete any work items needed to address physical needs that are immediate threats to health or safety. If this is not done, the PAE must evaluate the project's 35 eligibility for a Restructuring Plan under § 401.403, which permits rejection of certain projects in poor condition. The rule allows rejection of the request for a Restructuring Plan if the PAE cannot certify the owner's evaluation. Based on the completed PCA, the PAE also must consider rejecting a request for a Restructuring Plan even if there are no remaining immediate health and safety threats, if the PAE cannot determine that proceeding with a Restructuring Plan with necessary rehabilitation is more cost-effective in terms of Federal resources than rejecting the Request for a Restructuring Plan under § 401.403(b)(3) and providing tenant-based assistance for displaced tenants under § 401.602. HUD will provide guidance to PAEs for making the cost-effectiveness determination. The PAE must also advise HUD of the impact on tenants and the community of not proceeding with the Restructuring Plan. Rejections under this section may be disputed and appealed under subpart F.

Section 401.452 Property Standards for Rehabilitation

The standard for rehabilitation is a non-luxury standard adequate for the rental market intended at the original approval of the project-based assistance. The physical needs identified should be those necessary for the project to retain its original market position as an affordable project in decent, safe and sanitary condition (recognizing any evolution of standards appropriate for such a project). The rehabilitation should include those improvements the project requires to rent at all in the non-subsidized market, resulting in a marketable project that competes on

rent rather than on amenities. Rehabilitation must be in accordance with 24 CFR part 8, which contains requirements for accessibility to persons with disabilities, to the extent applicable. Where a range of options exists, the least costly options for rehabilitation should be chosen within that range, when both capital and operating costs are taken into consideration.

Section 401.453 Housing Quality Standards

Section 401.453 requires the owner to maintain the project in a decent safe and sanitary condition based on the housing quality standards identified in § 401.453. These standards apply as long as the Use Agreement under § 401.408 is in effect. Whenever the project is receiving project-based assistance, the applicable standards will be the physical condition standards for HUD housing under 24 CFR 5.703, published on September 1, 1998 (63 FR 46566). Otherwise, local codes will serve as the standards as long as local codes are as strict as HUD standards and do not severely restrict housing choice in the view of the PAE. In addition, any unit in which the tenant receives tenant-based assistance must comply with the housing quality standards of the section 8 tenant-based programs (24 CFR 982.401). Section 401.453 also requires the Restructuring Plan to provide for necessary replacement reserves.

Section 401.460 Modification or Refinancing of First Mortgage

Section 401.460 explains the standards for restructuring with a modified or refinanced first mortgage. This section provides for a variety of approaches to restructuring, which may include modification of the insured mortgage or refinancing with or without FHA insurance or other credit enhancement. The first mortgage will be a fully amortizing, level payment mortgage with a principal amount sustainable at rent levels that do not exceed the lower of section 8 rents allowed under the Mark-to-Market Program or rents permitted under the Use Agreement under § 401.408. Interest rates and other terms must be competitive in the market.

As part of sizing the first mortgage, the PAE should take into account any need for financing needed rehabilitation. The determination of the modified or refinanced first mortgage amount and the claim payment amount are directly related, and the claim payment under § 401.471 may be increased, in order to make proceeds from a refinanced first mortgage

available for rehabilitation. A similar adjustment in the first mortgage amount is permitted in the case of HUD-held mortgage debt although no claim payment is involved.

In the Program Manual, HUD will provide detailed guidance for PAE underwriting of the first and second mortgage. The PAE will be fully responsible for the second mortgage underwriting, while underwriting the first mortgage will also require the involvement of the mortgagee (and HUD, if refinancing involves FHA mortgage insurance or risk-sharing.) Due to the significant potential for conflicts of interest if the PAE provides the first mortgage financing, HUD will apply an exceptionally high level of review whenever this is proposed as part of the Restructuring Plan.

The monthly payment for the first mortgage under the Mark-to-Market Program will not exceed the current first mortgage payment. Interest rates and other terms must be competitive. Fees and costs above normal processing fees for a modification and refinancing will be paid by the owner from non-project funds and will not be financed through the first mortgage.

Credit enhancement for the refinanced mortgage may be provided for in the Restructuring Plan but is not required. If FHA continues to provide credit enhancement through mortgage insurance, any new insurance for a refinanced first mortgage will be provided under the usual FHA legal requirements but insurance for the refinanced mortgage will be documented through amendment of the existing insurance contract under section 517(b)(3) of MAHRA rather than through a new insurance contract. FHA will issue the commitment and endorse the mortgage for insurance, but may adapt its procedures to make appropriate use of the PAE.

If FHA credit enhancement for a refinanced first mortgage is provided through risk-sharing under 24 CFR part 266, the usual legal requirements under part 266 will apply but the PAE will need special HUD approval if it seeks to engage in risk-sharing for the project, and the conflict of interest provisions in § 401.700 will apply. This will involve, for example, more detailed HUD involvement in underwriting than would otherwise be applicable under part 266.

Credit enhancement may also be provided by a non-FHA party. The rule recognizes that there may be a conflict between the credit enhancer's usual requirements and the requirements of the interim rule. Although all non-statutory provisions in the interim rule

are subject to waiver under 24 CFR 5.110, the interim rule advises that HUD will consider waiver to accommodate a provider of credit enhancement only if the waiver will not materially impair achievement of the purposes of MAHRA and if the waiver is essential to meet the legitimate business or legal requirements of the provider of credit enhancement.

Some projects eligible for the Mark-to-Market Program are subject to more than one FHA-insured loan. A common combination is a section 236 first mortgage (often quite small) and a section 241(f) second mortgage. The feasibility of a Restructuring Plan for these projects will depend heavily on how the Plan deals with the junior insured mortgage. MAHRA does not deal expressly with this situation, but HUD has concluded that MAHRA permits restructuring of both insured mortgages. A section 541(b) claim might also be paid in connection with the existing insured second mortgage if needed, because section 517(b)(1) does not limit the payment of claim to a single insured mortgage. The modified or refinanced first mortgage required by § 401.460 would secure the debt that remained owing on the existing insured mortgages after payment of claims. Section 517(a)(1)(B) of MAHRA requires a second mortgage under a Restructuring Plan (discussed under § 401.461) in an amount that does not exceed the difference between the first mortgage under § 401.460 and the indebtedness under the existing insured debt. The result could be the replacement of both of the existing insured first and second mortgages with both a first mortgage with payments sustainable through the rents allowed by the Restructuring Plan and a second mortgage with deferred payments, with the sum of the two mortgage amounts not exceeding the sum of all insured mortgage amounts before restructuring.

There may be projects with multiple insured mortgages that can be successfully restructured without the need for full payment of claim on the existing insured first mortgage. In that case, the existing insured second mortgage could be left unchanged, modified, or refinanced, if subordinated to the new second mortgage required by MAHRA (see discussion under the next section.)

Section 401.461 HUD-Held Second Mortgage

Section 401.461 provides standards for the new second mortgage that must be given to HUD whenever the insured or HUD-held mortgage debt is written down through payment of a claim. The

new second mortgage is limited to an amount that the PAE reasonably expects to be repaid by the owner based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the project. It will bear simple interest of at least 1 percent but no more than the applicable Federal rate determined by the Department of the Treasury. The term will be concomitant with the term of the first mortgage under § 401.460 or, if there is none, the term will be set by HUD. The mortgage will become due and payable earlier in accordance with § 401.461(b)(3) if the first mortgage is terminated or paid in full (unless HUD provides otherwise in the case on a nominal first mortgage amount), if the mortgage is assumed by a purchaser of the project in violation of HUD guidelines, or if the owner fails to cure a statutory violation or a violation of a HUD requirement. Acceleration by HUD may be appealed under subpart F.

At least 75 percent of the project's net cash flow after payment of first mortgage debt service and operating expenses must be used to pay principal and interest on the second mortgage. The Restructuring Plan may provide for up to 25 percent of net cash flow to be paid to an owner who meets certain property management and housing quality standards.

HUD will consider modification or forgiveness of the second mortgage under the authority of section 517(a)(5) of MAHRA only if (1) the project has been sold or transferred to a priority purchaser under § 401.480, and (2) HUD determines that modification or forgiveness is necessary for recapitalization to preserve the project as affordable housing.

If the amount of a partial claim under § 401.471 exceeds the principal amount of the second mortgage, § 401.461(c) permits HUD to require the owner to give an additional subordinate mortgage on the project to HUD to secure repayment of the excess. This additional mortgage will be subordinate to other HUD-held mortgages, will bear interest at the same rate as the second mortgage under § 401.461(a), and will require no payments except payment in full when the second mortgage under § 401.461(a) is paid in full.

Section 401.471 HUD Payment of a Section 541(b) Claim

HUD payment of a section 541(b) claim is the means by which one or more FHA-insured or HUD-held mortgages will be paid down to the level of debt that can be supported at market rents. Section 541(b) of the National

Housing Act permits HUD to pay an insurance claim from the appropriate insurance fund for a mortgage that is not in default. In some cases, the debt than can be supported will remain in place through a modification and reamortization of the existing mortgage debt. In other cases it will be taken out by a new lender as a refinancing of the existing mortgage debt. All payments of claim will be made by HUD, from the appropriate insurance fund, to the mortgagee on behalf of the mortgagor. Section 517(b)(1) of MAHRA currently specifically directs that a partial payment of claim be made under section 541(b) of the National Housing Act, which authorizes partial payments on mortgages not in default in connection with the Mark-to-Market Program. Section 517(b)(1) also specifically includes a full payment of a claim as a possible restructuring tool, but there is no provision in the National Housing Act equivalent to section 541(b) that expressly authorizes full payment of claims for mortgages not in default. The ordinary authority for making full payments of claims on FHA-insured multifamily mortgages is section 207(g) of the National Housing Act, which applies only to mortgages in default. HUD will not approve any Restructuring Plan providing for a full payment of claim on a mortgage not in default unless HUD is satisfied that there is legal authority to use the appropriate FHA insurance fund to pay the claim. That may require a technical legislative amendment. Until HUD is able to make such full payments, any claim paid on a mortgage not in default would be a partial claim that leaves at least a nominal amount of the insured mortgage unpaid or paid from other sources, such as project accounts or owner contributions.

Section 401.472 Rehabilitation Funding

Section 517(b)(7) of MAHRA identifies some potential sources for funding needed rehabilitation of the project that are included in § 401.472. If project accounts (e.g., residual receipts, surplus cash and replacement reserve accounts) have amounts that exceed the initial deposit needed for the replacement reserve account, the excess must be used for rehabilitation before the other sources are used. Other potential sources include: (1) restructuring of the first mortgage debt to facilitate additional borrowing for rehabilitation (as discussed under § 401.460); (2) grants under the rehabilitation grant program under section 236(s) of the NHA (as discussed under § 401.473); and (3) increases in

section 8 budget authority for section 8 assistance contracts (to the extent HUD has determined that funding from this source is available). Rehabilitation funding will be disbursed through an escrow agent or other means determined by HUD.

HUD will implement section 517(b)(7)(B) of MAHRA by requiring the owner to contribute from non-project funds at least 20 percent of the total cost of rehabilitation. A reasonable proportion of the owner's contribution must come from non-governmental resources. HUD will provide further guidance in its Program Manual on the requirement for owner contribution from non-governmental resources. HUD estimates the requirement will be a minimum of 3 percent of the total cost of rehabilitation.

The PAE may require a larger owner contribution for a particular project. To the extent the owner voluntarily provides more than the required 20 percent, the PAE may consider allowing in the Restructuring Plan for more extensive rehabilitation and appropriate adjustments to the reserves for replacement analysis. The PAE may exempt housing cooperatives from the owner contribution requirement.

Section 401.473 HUD Grants for Rehabilitation Under Section 236(s) of NHA

This section authorizes rehabilitation grants under Restructuring Plans. HUD has concluded that rehabilitation grants under section 236(s) of the National Housing Act (NHA), as added by section 531 of MAHRA, may be made available under authority of this interim rule for Mark-to-Market projects. HUD's usual practice is to implement a new grant program through either a proposed/final rule procedure or, if that procedure allows insufficient time for obligation of appropriated funds before they lapse, through a Notice of Funding Availability (NOFA). However, by implementing the various requirements of the Mark-to-Market Program, this interim rule will ensure that any use of section 236(s) grant funds in connection with a Restructuring Plan, before separate grant regulations are issued, is in accord with statutory requirements as long as an appropriate grant agreement is used by HUD. There is no requirement for a competitive grant process using a NOFA under section 102 of the HUD Reform Act of 1989. HUD has concluded there would be no public benefit in delaying the availability of section 236(s) grant funds for Mark-to-Market projects until after a separate rulemaking procedure was completed. HUD expects to pursue a

separate rulemaking procedure before any use of the section 236(s) grant authority outside of the Mark-to-Market Program. Section 401.473 permits HUD to delegate grant administration of a section 236(s) rehabilitation grant to a PAE that is a government entity, as provided in section 236(s)(5) of the NHA (added by section 531 of MAHRA), and to pay for grant administration from grant funds if they are available for this purpose.

Section 401.474 Project Accounts

Section 401.474 permits the Restructuring Plan to provide for the use of project accounts. Accounts of one project may be used for other eligible projects if: (1) the projects are included in a consolidated Restructuring Plan under § 401.400(a)(2); and (2) the funds are used to fund project rehabilitation or to reduce the amount of a claim paid by HUD under § 401.471. The Restructuring Plan may provide for up to 10 percent of the excess project funds to be paid to the owner after completion of the rehabilitation required by the Restructuring Plan.

Section 401.480 Voluntary Sale or Transfer of Project

Section 401.480 covers the voluntary sale or transfer of a project as part of the Restructuring Plan. An eligible owner may request sale or transfer. If the owner is determined to be ineligible for a Restructuring Plan under § 401.101 or 401.403, a Restructuring Plan can be developed only if it involves sale or transfer.

The owner must notify HUD or the PAE of the owner's intent to transfer the property. If the owner is determined to be ineligible under § 401.101 or § 401.403, this notice must be received by HUD or the PAE within 30 days after the owner receives notice of rejection and all objection and appeals procedures have been concluded, if applicable. Otherwise, the owner should provide the notice as part of its initial request for a Restructuring Plan or at any later time when it is still feasible, in the determination of the PAE, to develop a Restructuring Plan involving sale or transfer.

An ineligible owner must inform the PAE of any intention to accept a purchase offer, subject to PAE approval and HUD approval of the Restructuring Plan. The owner must also prepare a notice to potential purchasers that describes the project and the procedure for submitting purchaser offers. The notice must be in a form acceptable to HUD and will be subject to review and approval by HUD or the PAE. The

owner must distribute and publish an approved notice as required by HUD.

This section gives a preference to certain "priority purchaser" groups, defined as tenant organizations, tenant-endorsed community-based nonprofit organizations, and tenant-endorsed public agency purchasers. HUD may also establish qualifications for priority purchasers. If an owner has been rejected, the PAE must not develop a Restructuring Plan involving a sale or transfer to a non-priority purchaser unless it determines that there is no interested qualified priority purchaser, or that no feasible Restructuring Plan can be developed involving a sale or transfer to a qualified priority purchaser.

All project sales are subject to PAE approval and HUD approval of the Restructuring Plan.

Section 401.481 Subsidy Layering Limitations on HUD Funds

Section 401.481 explains the subsidy layering certification that a PAE must make under section 514(e)(7) of MAHRA. The purpose of the subsidy layering certification procedure is to ensure that any HUD assistance provided to the owner of a project under the Restructuring Plan is no more than is necessary to permit the project to continue to house a tenant mix comparable in income to the tenant income mix of the project before the Restructuring Plan is implemented, after taking into account other Federal, State or local governmental assistance of any kind such as grants, loans, guarantees, or tax credits or other tax benefits.

HUD is generally required to make a subsidy layering certification under section 102(d) of the HUD Reform Act of 1989 when HUD assistance is provided. Section 911 of the Housing and Community Development Act of 1992 provided for HUD delegation of the subsidy layering certification requirements to certain State or local agencies (defined in section 42 of the Internal Revenue Code of 1986 as "housing credit agencies" or HCAs) for projects receiving a low-income housing tax credit (LIHTC). MAHRA does not explicitly provide for assumption of HUD's duties under section 102(d) by a PAE, but HUD does not consider it Congress' intention to require HUD to duplicate the PAE's efforts by performing separate section 102(d) subsidy layering certifications in connection with HUD assistance that was included in a Restructuring Plan approved by HUD with benefit of the PAE's subsidy layering certification. That would be inconsistent with the express MAHRA provision for a PAE

subsidy layering certification, and with the general approach of MAHRA in making the PAE responsible for the analysis and development of Restructuring Plans for individual projects. Therefore, HUD may rely on the PAE's certification and does not need to perform a separate subsidy layering analysis.

If the PAE is an HCA with delegated authority under section 911, it will perform the subsidy layering certification for MAHRA using procedures substantially similar to the published HUD guidelines for section 102(d) certifications under section 911. Such a PAE may, and any other PAE must, submit for HUD approval other subsidy layering certification procedures that follow the section 911 guidelines to the extent feasible and appropriate.

The PAE's subsidy layering analysis should not restrict the availability of HUD assistance solely because an owner is able to obtain public resources, such as grants, for use as some or all of the owner's required contribution toward rehabilitation costs (see § 401.472(b)) from public resources.

§ 401.483 Leasing Units to Certify and Voucher Holders

Section 514(e)(9) of the Act only prohibits refusal to lease a "reasonable number" of units to section 8 voucher or certificate holders because of their status as voucher or certificate holders. HUD has determined that for a project under the Mark-to-Market Program, the "reasonable number" of units that should be available to voucher or certificate holders is 100 percent of the units. Under § 401.483, the Restructuring Plan will not permit an owner to reject any prospective tenants solely because of their status as holders of vouchers or certificates.

§ 401.484 Property Management Standards

Section 401.484 implements part of section 518 of MAHRA, which requires a PAE to establish management standards for a project pursuant to HUD guidelines and consistent with industry standards. Section 401.484 also relates to implementation of sections 514(e)(4) and 517(a)(3) of MAHRA. HUD's guidelines set forth in this section require the property manager to, at a minimum:

(1) Protect the physical integrity of the property over the long term through appropriate requirements for preventative maintenance, repair or replacement (compliance with this standard would be evidenced by no unscheduled deferred maintenance,

complete maintenance records with work performed in a workmanlike manner at competitive costs, and "satisfactory" reviews by HUD);

(2) Ensure the routine cleaning of the building and grounds;

(3) Maintain good relations with the tenants;

(4) Protect the financial integrity of the project by operating with the budget provided by the owner, with competitive and reasonable operating expenses and appropriate insurance;

(5) Take measures to achieve physical safety and maintenance of insurance; and

(6) Comply with any other HUD management requirements including termination of the management agent for cause.

HUD will provide additional guidance on management standards in the program manual. The PAE's management standards must also conform to any HUD guidelines and industry standards on conflicts of interest between owners, managers and contractors.

Section 401.500 Required Notices to Third Parties; Section 401.501 Who Is Entitled To Receive Notices Under § 401.500?

Under §§ 401.500 and 401.501, a PAE must solicit and document the consideration of tenant and local community comments. These sections describe the procedures for ensuring that third parties affected by the restructuring of a project through the Mark-to-Market Program are kept informed and provided the opportunity to provide comments at crucial stages of the process. Section 401.500 describes two notices that will be used to keep interested third parties informed: (1) a notice of intent to restructure and of a consultation meeting in 20–60 days; and (2) a notice of the completed Restructuring Plan. Each notice is to be given by the owner to: (1) each project tenant, or a tenant association; (2) the Chief Executive Officer of the unit of general local government; and (3) the Director of the Public Housing Authority (PHA) with jurisdiction over the project. The PAE or HUD may also identify any neighborhood representatives and other affected parties that should receive one of more of these notices.

The PAE must also conduct a consultation meeting to receive oral presentations and comments on the desired contents of a Restructuring Plan, desired contents of a Rental Assistance Assessment Plan (if one is required), and on any proposed transfer of the project. The PAE will invite

participation by at least the parties entitled to receive notices.

Section 514(b) of MAHRA requires HUD to establish notice procedures and hearing requirements for tenants and owners concerning the dates for the expiration of project-based assistance contracts for any eligible multifamily housing project. For projects being restructured through the Mark-to-Market Program, HUD considers this provision satisfied through the notice and consultation meeting provisions of these sections. Specifically, § 401.500(b)(1)(iv) requires notice of the date of expiration for the contract (which may be a contract extended during Restructuring Plan development under § 401.600), and the consultation meeting will give all interested parties an adequate opportunity for a hearing on any concerns associated with expiring project-based assistance.

HUD does not interpret section 514(b) as applicable if an owner of an eligible project does not pursue restructuring under the Mark-to-Market Program, either by choice, because of the exceptions in section 514(h) of MAHRA, or because the owner or project is rejected under section 516. In particular, if a contract will not be renewed, HUD does not consider that Congress intended to impose additional notice requirements beyond the 180-day or 12-month notice of non-renewal required by section 8(c)(9) of the U.S. Housing Act of 1937 or section 514(d) of MAHRA, respectively, whichever applies, and the 90-day notice of rent increase under section 8(c)(8) of the 1937 Act (see § 401.602). If a contract is being renewed for a project not being restructured, there would be no apparent purpose for a notice requirement. In addition, HUD does not consider that Congress intended to require a hearing for tenants and owners concerning the expiration of contracts for projects not being restructured under the Mark-to-Market Program.

Subpart D—Implementation of the Restructuring Plan After Closing

Section 401.550 Monitoring and Compliance Agreement

Section 401.550 implements section 519 of MAHRA by providing for periodic monitoring (including onsite inspections) and by generally requiring PAEs to ensure that owners comply with approved Restructuring Plans, including execution and recording of a Use Agreement. As long as there is a PAE for the project that is qualified to be a section 8 administrator (i.e., a State or local housing agency), the PAE will be responsible for monitoring and

enforcement; if not, HUD will perform those functions. The onsite inspections under this section will be required to follow uniform inspection procedures of HUD in 24 CFR 5.705 published on September 1, 1998 (63 FR 46566). The GAO and HUD (including HUD's Office of Inspector General) also may audit a project with a Restructuring Plan pursuant to section 519(c) of MAHRA. HUD intends to include in the final rule more specific provisions regarding the means by which PAEs who are State or local housing agencies (i.e., "Phase I" applicants under the RFQ) will enforce compliance with the Restructuring Plans. HUD views the continuing involvement of the PAEs in the monitoring and compliance process as an important enhancement of HUD's own efforts. HUD welcomes the views of State and local housing agencies and others regarding the availability of effective enforcement tools that may be feasible and cost-effective means of ensuring long-term compliance by project owners, including enforcement tools that have been successfully used by the agencies.

Section 401.552 Servicing of Second Mortgage

HUD or its designee will be responsible for servicing the second mortgage including the determination of the amount of the net cash flow receivable by the owner. HUD may designate the PAE as servicer with its consent.

Section 401.554 Contract Administration

Section 401.554 requires HUD to offer to any PAE qualified to be the section 8 contract administrator the opportunity to serve as contract administrator. The term "qualified" is intended to indicate that a contract administrator must meet both statutory requirements of the United States Housing Act of 1937 (e.g., be a public housing agency) and any additional requirements of HUD established under the applicable section 8 program by the responsible HUD officials. As contract administrator, the PAE must offer to renew section 8 contracts in accordance with the Restructuring Plan as provided in section 515(a) of MAHRA.

A contract administrator for section 8 tenant-based assistance provided under this rule has a significantly different and expanded role far beyond the scope of a section 8 project-based administrator. For instance, the section 8 tenant-based contract administrator is responsible for administering the assistance throughout its jurisdiction, not just in the particular project. The PAE and any other

prospective tenant-based contract administrators are advised to carefully review the tenant-based program regulations at part 982, with particular emphasis on § 982.51 ("HA authority to administer program") and § 982.153 ("HA responsibilities"). Any PAE proposing to serve as contract administrator must understand that a section 8 tenant-based assistance administrator's duties may extend beyond the usual responsibilities of a contract administrator due the need to ensure appropriate treatment of displaced tenants in accordance with the "portability" provisions of MAHRA.

Subpart E—Section 8 Requirements for Restructured Projects

Section 401.595 Contract and Regulatory Provisions

Section 401.595 provides that the provisions of 24 CFR chapter VIII (i.e., other section 8 program regulations) will apply only to the extent, if any, provided in the contract. In accordance with section 515(c)(5) of MAHRA, 24 CFR part 983 will not apply.

Section 401.600 Will a Section 8 Contract be Extended if it Would Expire While an Owner's Request for a Restructuring Plan is Pending?

Under § 401.600, an owner that has requested development of a Restructuring Plan may receive a section 8 contract extension at current rents for the shortest reasonable period needed for the PAE to complete a Restructuring Plan for the project (generally, not more than 9 months). Any extension of the contract beyond 1 year pending closing on the Restructuring Plan would be at comparable market rents or exception rents, but would not affect the project's continued eligibility for the Mark-to-Market Program.

Although section 514(c) of MAHRA may be interpreted to require immediate reduction to comparable market rents, HUD has concluded that the provision is better reconciled with MAHRA as a whole if it is interpreted to permit an extension at current rents for a reasonable period, along the lines of the current Portfolio Reengineering demonstrations, with further extensions at comparable market rents (or exception rents, if applicable) if a Restructuring Plan is underway but has not been developed and approved expeditiously. This will avoid the abrupt disruption that section 514(c) appears designed to avoid when an eligible owner has requested a Restructuring Plan.

Section 401.601 Consideration of an Owner's Request to Renew an Expiring Contract Without a Restructuring Plan

Section 401.601 provides a procedure for considering an eligible owner's request for renewal of an expiring contract without requesting a Restructuring Plan. Because rents must exceed comparable market rents for § 401.100 to apply, this section of the interim rule does not apply to projects with rents at or below comparable market rents.

HUD or the PAE will determine whether renewal under § 402.4 at rents that do not exceed comparable market rents would be sufficient to maintain an adequate debt service coverage ratio on the first mortgage and necessary project reserves. If so, the contract renewal will be processed under new § 402.4. If not, a Restructuring Plan must be developed by a PAE before further consideration of the owner's request. HUD is not defining "adequate debt service" in this interim rule but intends to provide guidance to PAEs in the Program Manual.

Section 401.602 Tenant Protections if an Expiring Contract is not Renewed.

The rule does not require an owner who is eligible to apply for a Restructuring Plan under § 401.100 and has an expiring project-based contract to apply. The rule permits the owner not to request a Restructuring Plan and not to renew the contract if the owner provides the 180-day notice of non-renewal under section 8(c)(9) of the United States Housing Act of 1937 and the 90-day notice of any resulting rent increases under section 8(c)(8) of that Act. An owner who does not give the proper notices must continue to permit residents to stay in their units without increasing the tenant portion of the rent until a period equivalent to the required notice period (180 or 90 days, as applicable) has expired after the later of the date proper notice was given or the date the contract expired. The same obligation applies if the owner requested a Restructuring Plan but was rejected by HUD or the PAE under § 401.101 or 401.403.

An owner who has requested a Restructuring Plan and is not rejected may not fail to renew an expiring contract without giving the 12-month notice to HUD and tenants required by section 514(d) of MAHRA and the 90-day notice of any resulting rent increases under section 8(c)(8) of the United States Housing Act of 1937. If the notice is not given, the tenants have similar protections as discussed in the

preceding paragraph, except that 12 months applies instead of 180 days.

If a contract is not renewed, HUD will make tenant-based assistance available to tenants in two circumstances. As provided in section 514(d) of MAHRA, HUD will make such assistance available to all tenants residing in units assisted under the expiring contract if the owner does not renew project-based assistance. As provided in section 516(d) of MAHRA, HUD will make tenant-based assistance available to all tenants residing in a project at the time HUD or the PAE reject an owner or a project under §§ 401.102 or 401.403 if: (1) the tenant is a low-income family; or (2) the tenant is receiving tenant-based assistance. Both tenant-based assistance, and the availability of funds for moving expenses of displaced tenants, will depend on the availability of funds under future appropriations Acts.

Section 401.605 Project-Based Assistance Provisions

Section 401.605 indicates that the project-based assistance restructured rents will be determined under the Restructuring Plan.

Section 401.606 Tenant-Based Assistance Provisions

Section 401.606 complies with section 515(c)(3) of MAHRA by providing that, if the Restructuring Plan provides for tenant-based assistance, assistance under part 982 will be offered to each eligible family assisted under the section 8 project-based assistance contract on the date of expiration. The Department intends to revise as soon as possible, by interim rule, the section 8 tenant-based regulations at part 982 to incorporate the unique statutory provisions of section 515(c)(4) of MAHRA for the tenant-based assistance offered to families through a Restructuring Plan.

Section 401.607 Contract Term

Renewals will be for a term determined by HUD by the appropriate HUD office, but the owner is not required to accept a renewal beyond the 30-year term of the use and affordability restrictions required under the Mark-to-Market Program.

Subpart F—Owner Dispute of Rejection and Administrative Appeal

Section 401.645 How Does the Owner Dispute a Notice of Rejection?

Section 401.645 provides the owner an opportunity to dispute the following: (1) when a request for a Restructuring Plan is rejected; (2) when a request for a section 8 contract renewal is rejected; (3) when a PAE cannot continue with a

Restructuring Plan because of lack of owner cooperation under § 401.402; and (4) when HUD rejects a proposed Restructuring Commitment submitted by a PAE. HUD or the PAE will notify the owner of the reasons for a rejection and provide a 30-day period to submit written objections or cure the problem. If no objection is submitted, the rejection is not subject to judicial review under section 516(c) of MAHRA. If an objection is submitted, HUD or the PAE will send the owner a final decision affirming, modifying, or reversing the initial rejection with reasons for the decision. This final decision is appealable under § 401.650.

Section 401.650 When May the Owner Make an Administrative Appeal of a Final Decision Under This Subpart?

An owner may appeal a final decision under § 401.645(b) if written objection was made. In addition, an owner may appeal a decision of HUD to approve a Restructuring Commitment if the owner does not execute the Commitment, and a decision of HUD to accelerate the HUD-held second mortgage under § 401.461(a).

Section 401.651 Appeal Procedures

Section 401.651 provides a simple, expeditious means through which an owner may make a presentation (written, oral, and/or through a representative) at a conference with an official of HUD who was not involved in making the decision under appeal. The HUD or PAE official who issued the decision under appeal will also participate.

An owner must appeal any decision within 10 days of receiving notice of the decision. The appeal will be decided by a written decision issued within 20 days of the conference. Days will be computed as provided in 24 CFR 26.16, but the hearing procedures of part 26 of this title do not otherwise apply. Although representation by legal counsel is permitted, the appeal procedure under this part is intended to be informal, without rules of evidence or presentation of witnesses. Its purpose is to ensure that no pertinent facts have been overlooked and to avoid serious errors of judgment.

Section 401.652 No Judicial Review

Section 401.652 states that the decision of a reviewing official under § 401.651 is a final determination for purposes of section 516(c) of MAHRA, which forbids judicial review of a final determination.

III. Content of Part 402

Section 402.1 What is the Purpose of Part 402?

Section 402.1 explains that part 402 sets out the terms and conditions under which HUD will renew project-based assistance section 8 contracts under section 524(a)(1) or (2) of MAHRA. Part 402 deals exclusively with the renewal of section 8 contracts for projects without a Restructuring Plan under the Mark-to-Market Program under part 401. Therefore, either the Office of Housing or the Office of Public and Indian Housing is responsible for the contract extension. However, part 402 is included under the new CFR chapter for the Office of Multifamily Housing Assistance Restructuring (OMHAR) because of section 522(a)(1) of MAHRA, which provides that regulations implementing subtitle A of MAHRA (including section 524) are to be issued by the Director of OMHAR. Secretary Cuomo has signed this interim rule as provided in section 522(a)(1) because no Director has yet been appointed.

Section 402.2 Definitions

Section 402.2 applies the definitions in part 401 to part 402.

Section 402.3 Contract Provisions

Section 401.3 provides that the provisions of 24 CFR chapter VIII (i.e., other section 8 program regulations) will apply only to the extent, if any, provided in the contract. Part 983 of 24 CFR will not apply, in accordance with section 515(c)(5) of MAHRA.

Section 402.4 Contract Renewals Under Section 524(a)(1) of MAHRA

Section 402.4 sets out the basic rule on section 8 contract renewals for projects that are not involved in the Mark-to-Market Program under part 401. If the project is eligible for the Mark-to-Market Program under part 401, the owner's request for renewal will be processed under § 401.601 to determine whether a Restructuring Plan is needed before a renewal proceeds under this part 402. This section implements section 524(a)(1) of MAHRA by authorizing renewal at rents that do not exceed market comparable rents, with future rent adjustments using the operating cost adjustment factor (OCAF) as provided for the Mark-to-Market Program under § 401.412, except that rents may be redetermined using a budget-based rent adjustment from time-to-time at the discretion of HUD. OCAF and budget-based adjustments may be positive or negative. If the owner of a project so requests, § 402.4 will not apply to a project in certain classes of

“exception projects” identified in section 524(a)(2) of MAHRA, which are covered in the next section.

Section 402.5 Contract Renewals Under Section 524(a)(2) of MAHRA

Section 402.5 concerns renewals under section 524(a)(2) of MAHRA, only at the request of the owner, for the following classes of “exception projects”:

(1) A project for which the primary financing or mortgage insurance was provided by a unit of State government or a unit of general local government (or an agency or instrumentality of either) and was not insured under the NHA;

(2) A project for which the primary financing was provided by a unit of State government or a unit of general local government (or an agency or instrumentality of either) and the financing involved mortgage insurance under the NHA, such that the implementation of a Restructuring Plan is in conflict with applicable law or agreements governing such financing;

(3) A project for the elderly financed under section 202 of the Housing Act of 1959 or section 515 of the Housing Act of 1949;

(4) A project that has an expiring contract section 8 moderate rehabilitation contract for single room occupancy dwellings; or

(5) A project that does not qualify as an eligible project under part 401 of this chapter (i.e., because rents do not exceed comparable market rents or because there is no HUD-insured or HUD-held mortgage).

(The second class of projects is described in section 524(a)(2)(B) of MAHRA. Unless section 514(h) of MAHRA is amended, no projects will fall in that category, as explained in Part II of this Supplementary Information under § 401.100.)

The first four categories are included in § 402.5(b)(1); the last category is included in § 402.5(b)(2). The owner of an exception project identified in § 402.5(b) may request renewal under either § 402.4 or this § 402.5. The owner of a project identified in § 402.5(b)(2) that has a HUD-insured or HUD-held mortgage may proceed under this § 402.5 only if the HUD analysis confirms that project rents are below comparable market rents.

If the owner of an exception project requests renewal of project-based assistance under this section, HUD is required (subject to a right to reject under § 402.7, and confirmation of rents levels for a project under § 402.5(b)(2))) to renew the expiring contract with initial rents at the lesser of: (1) existing rents adjusted by an operating cost

adjustment factor (OCAF) established by HUD; (2) a budget-based rent determined in accordance with the statutory directions for determining budget-based rent under the Mark-to-Market Program (except that HUD rather than a PAE will determine operating expenses and HUD may adjust the debt service component to reflect competitive interest rates); or (3) in the case of a contract under the section 8 moderate rehabilitation program (other than for a single room occupancy dwelling), the base rent adjusted by applying an OCAF to the base rent, minus any costs associated with debt service, with the OCAF to be applied to rents for each unit size assisted under the renewal contracts.

Rent adjustments at contract renewal will use the same OCAF allowed under § 401.412 for the Mark-to-Market Program, except that rents may be redetermined using a budget-based rent adjustment from time-to-time at the discretion of HUD. OCAF and budget-based adjustments may be positive or negative. The HUD official responsible for the particular section 8 program involved will determine the term of any initial and subsequent renewals, subject to the availability of appropriated funds.

Section 402.6 What Actions Must an Owner Take to Request Section 8 Contract Renewal Under This Part?

Section 402.6 provides a procedure for requesting renewal under part 402 which is similar to § 401.99 for Mark-to-Market projects. At least 3 months before the expiration date of any project-based assistance on a project, or as soon as practicable if the contract expires less than 3 months after the effective date of this interim rule, the owner must submit to HUD (or the contract administrator for a contract under the moderate rehabilitation program): (1) a certification that neither the owner nor any affiliate is suspended or debarred; (2) a comparable market rent analysis indicating that project rents are above comparable market rents (using the same approach in § 401.410 for the Mark-to-Market Program) except for most exception projects; and (3) if the owner is seeking renewal under § 402.4, the most recent annual audited financial statement for the project, and the owner's evaluation of physical needs complying with § 401.450. Rent comparability is to be determined by an independent State-certified general appraiser hired by the owner, using the guidance given to the PAE under § 401.410. An interim contract extension may be provided when an owner's request for renewal under § 402.4 or § 402.5(b)(2) is pending.

These procedures do not apply to renewals of section 8 moderate rehabilitation contracts (other than contracts for single room occupancy dwellings under section 441 of the Stewart B. McKinney Homeless Assistance Act.) HUD's Assistant Secretary for Public and Indian Housing will issue separate procedures.

Section 402.7 Refusal to Consider an Owner's Request for a Section 8 Contract Renewal Because of Actions or Omissions of Owner or Affiliate

To ensure that contracts are not renewed for unacceptable owners, § 402.7 permits HUD to reject a renewal request in a manner similar to § 401.403 for projects eligible for Mark-to-Market restructuring. The dispute and administrative appeal provisions of subpart F of part 401 apply.

Section 402.8 Tenant Protections if an Expiring Contract is not Renewed

Section 402.8 is similar to § 401.602. If an owner fails to renew an expiring contract for section 8 project-based assistance, the owner must provide the 180-day advance notice of non-renewal under section 8(c)(9) of the United States Housing Act of 1937 and the 90-day notice of rent increase under section 8(c)(8) of that Act. An owner who does not give the proper notice must continue to permit residents to stay in their units without increasing the tenant portion of the rent until 180 days (or 90 days, depending on which notice was not given in a timely manner) after the later of the date proper notice was given or the date the contract expires.

Electronic Access and Filing Addresses

If you wish to comment on this interim rule, you may submit comments through HUD's Public Comment Webpage accessible through the Internet at <http://www.hud.gov/ogc/regcom2.htm/>. That webpage will enable you to create an e-mail message containing your comments. Your comments will be sent to the Rules Docket Clerk and will be available to any person. If you send your comment through the Public Comment Webpage, please DO NOT also send a paper copy of your comment.

Findings and Certifications

Paperwork Reduction Act

The information collection requirements contained in §§ 401.101, 401.102, 401.200, 401.202, 401.302, 401.403, 401.404, 401.405, 401.410, 401.421, 401.473, 401.480, 401.481, 401.500, 401.450, 401.451, 401.601, 401.602, 401.603, 401.651, 402.4 and 402.6 of this interim rule have been

submitted to the Office of Management and Budget (OMB) for emergency review and approval in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor and a person is not required to respond to, a collection of information unless the collection displays a valid control number. The OMB control number, when assigned, will be published in the **Federal Register**, together with any changes in the information collection requirements that may result from the approval process. The OMB approval number will be assigned before the rule takes effect.

In addition, HUD has submitted to OMB a request for non-emergency approval for the information collection requirements of this interim rule and for an extension of the approval of the information collection requirements contained in the Request for Qualifications (RFQ) published on August 17, 1998, at 63 FR 44102. (The information collection requirements in the RFQ were approved by OMB on an emergency basis through February 28, 1999 with OMB control no. 2502-0531.)

In accordance with 5 CFR 1320.5(a)(1)(iv), the Department is setting forth the following concerning the collections of information:

(1) Title of the information collection proposal:

Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-to-Market) Regulations and Request for Qualifications (RFQ)

(2) Summary of the collection of information:

The rule and the RFQ seek information from entities that may become participating administrative entities. The information concerns these entities' capacity and experience relating to their respective abilities to carry out the statutory functions of PAEs. The rule also contains collections of information from owners relating to mortgage restructurings.

(3) Description of the need for the information and its proposed use:

The information is needed to determine the qualifications of entities to become PAEs. It is also needed to develop statutorily required mortgage restructuring and rental assistance sufficiency plans. Finally, the information includes notices and related documents that implement various statutory procedures.

(4) Description of the likely respondents, including the estimated number of likely respondents, and proposed frequency of response to the collection of information:

Respondent will include entities applying for and that are PAEs, owners of projects HUD-insured or -held mortgages with expiring Section 8

contracts. The estimated number of respondents and frequency of response is included in paragraph (5), immediately below.

(5) Estimate of the total reporting and recordkeeping burden that will result from the collection of information:

Information collection	Number of respondents	Responses per respondent	Total annual responses	Hours per response	Total Hours	Regulatory reference
Owner Request for MRRAS Plan.	250	1	250	100	25,000	401.101
Owner cost/benefit analysis	235	1	235	1	235	401.480
Evaluation of rehabilitation needs.	235	1	235	35	8,225	401.451
Owner request to renew Section 8 without an MRRAS plan.	160	1	160	15	2,400	402.4
Owner submission in connection with 524(a) renewal.	140	1	140	40	5,600	402.6
Owner notice of non-renewal.	20	1	20	2	40	401.602
PAE notice to owner of refusal to consider request.	10	1	10	15	150	401.603
Owner appeal of a decision	27	1	27	16	432	401.651
Owner's notice of intent to sell.	25	1	25	1	25	401.481
Information needed to develop a HUD-approved MRRAS plan.	250	1	250	140	35,000	401.200 401.403 401.404
Third party notice	250	1	250	3	750	401.405
Market comparable rent determination.	250	1	250	40	10,000	401.410
Information needed to develop a rental assistance plan.	250	1	250	10	2,500	401.421
Physical needs assessment.	250	1	250	40	10,000	401.451
Third party notices	250	1	250	2	500	401.601
PAE subsidy layering certification.	250	1	250	20	5,000	401.500
PAE Notice of Refusal	25	1	25	10	250	401.102
Owner request for administrative review.	20	1	20	3	60	401.102
Response to RFQ	50	1	50	40	2,000	401.202
PAE Record Keeping	45	1	45	10	450	401.302
PAE reporting	45	1	45	10	450	401.302
PAE reports on projects subject to RAA plan.	45	1	45	30	1,350	401.450
Notice of rejection	10	1	10	10	100	401.473
Totals			3,002	101,157		

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of the public and affected agencies concerning the collection of information in this interim rule and the Request for Qualifications published on August 17, 1998, at 63 FR 44102 to:

- (1) Evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
- (3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond; including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this interim rule. Comments must refer to this interim rule by name and docket number (FR-4298).

Comments on the emergency submission must be submitted by September 18, 1998. Comments on the regular non-emergency submission must be submitted by November 10, 1998.

Submit comments to: Joseph F. Lackey, Jr., HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503; and

Reports Liaison Officer, Oliver Walker, Department of Housing and Urban Development, 451 7th Street, SW, Room 9116, Washington, DC 20410.

Justification for Interim Rule and Shortened Comment Period

It is the general practice of the Department to provide a 60-day public comment period on all rules in accordance with 24 CFR part 10. However, section 522(a)(1) of MAHRA requires that this rule be issued as an interim rule; i.e., as a rule that will take

effect without the benefit of public comments. Section 522(a)(2) requires subsequent issuance of a final rule by October 27, 1998 or, if later, 3 months after the Director of the Office of Multifamily Housing Assistance Restructuring is appointed. Hence, the Department invites public comment on the interim rule, but is providing a 45-day comment period instead of the usual 60-day period in order to minimize the period of operation under the interim rule as desired by Congress. The comments received within the 45-day comment period will be considered during development of a final rule that will supersede this interim rule as soon as feasible. In order to provide the fullest and most expedient access to the provisions of this interim rule, HUD will make it available on the World Wide Web at <http://www.hud.gov> on the date of publication in the **Federal Register**.

This interim rule also contains a partial implementation of the rehabilitation grant authority of section 236(s) of the National Housing Act, as added by section 531 of MAHRA. The interim rule authority in section 522(a)(1) of MAHRA directly applies only to subtitle A of MAHRA, and section 531 appears in subtitle B. However, the Department has concluded that section 522(a)(1) is authority for a limited implementation of section 236(s) through an interim rule as part of the Mark-to-Market Program because a rehabilitation grant included in a Restructuring Plan in compliance with part 401 will necessarily comply with the statutory and other desirable regulatory requirements for a section 236(s) grant. No public purpose would be served by a separate rule that duplicated many of the part 401 requirements in the context of a grant made as part of a Restructuring Plan, and HUD does not read the statute as requiring the separate rule.

Environmental Impact

A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4223). The Finding is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 7th Street, SW, Washington, DC 20410.

Executive Order 12866

The Office of Management and Budget (OMB) reviewed this interim rule under Executive Order 12866, *Regulatory Planning and Review*, issued by the President on September 30, 1993. OMB determined that this rule is a "significant regulatory action," (but not economically significant) as defined in section 3(f) of the Order. The interim rule will have effects outside the government, such as rehabilitation costs and associated benefits of improved housing. Based on experience under earlier demonstration authority, HUD has estimated that these effects outside of the Government do not total more than \$100 million annually.

Any changes made in this rule subsequent to its submission to OMB are identified in the docket file. The docket file is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this interim rule before publication and by approving it certifies that this rule does not have a significant economic impact on a substantial number of small entities. The rule implements recently-enacted legislation that created a Mark-to-Market Program through which section 8 rents for multifamily projects with HUD-insured or HUD-held mortgages will be reduced in order to preserve low-income rental housing affordability while reducing the long-term costs of project-based rental assistance and minimizing the adverse effect on the FHA insurance funds. As the preamble to the rule explains, section 8 assistance is costly to the Federal Government and the cost is rising. To preserve affordable housing, the Congress determined that reduction of section 8 assistance was necessary. Reduction or elimination of section 8 assistance without some type of transition or conversion process may mean that current projects assisted by section 8 may be unable to meet their financial obligations including operating expenses, current and future capital needs, and debt service payments—particularly payments on FHA-insured mortgages. To avoid this situation, the authorizing legislation and this interim rule provides for a mortgage restructuring program.

In this interim rule, the Department strives to provide flexible requirements

in order to reduce any burden on small entities. Owners of eligible projects that are small entities, who might otherwise be unable to meet their monthly mortgage payments after HUD reduces section 8 rents to comparable market rents as mandated by law, are provided an opportunity to receive a reduction in monthly mortgage payments if they request a mortgage restructuring under the rule. As conditions of the mortgage restructuring the owners will be required to rehabilitate the project so that it meets minimum standards of housing quality and to provide for competent management. These are not new economic burdens on owners, but are project matters which owners already have a responsibility to address and should be addressing even without mortgage restructuring. The only actions required of the owner are those needed to ensure that a project provide decent and safe housing to those intended to benefit from the Federal programs involved (FHA mortgage insurance and section 8 housing assistance payments.) Again, under existing HUD regulations and contracts, owners are now subject to a decent, safe, and sanitary standard or a good repair standard. Owners choosing to request a mortgage restructuring under this interim rule will continue to serve the same tenant income mix as before and will not be required to provide additional affordable housing.

Some of the Participating Administrative Entities (PAEs) selected under the interim rule, such as nonprofit organizations and for-profit entities, may be small entities. In the interim rule HUD has chosen to preserve for the PAE substantial discretion, within the limits of the statute, to choose the most cost-effective way of undertaking the mortgage restructuring of projects assigned to the PAE. No more projects will be assigned to a PAE than a PAE is able and willing to deal with. Each nonprofit and for-profit PAEs will partner with a public entity to provide additional resources and reduce the burden of undertaking restructurings.

Nothing in the interim rule imposes an adverse or disproportionate burden on a small entity. Small entities are specifically invited, however, to comment on whether this interim rule will significantly affect them, in accordance with the instructions in the DATES and ADDRESSES sections in the preamble of this interim rule. Such comments will be considered when a final rule is developed.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, *Federalism*, has determined that the policies contained in this interim rule do not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal Government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the interim rule is not subject to review under the Order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4; approved March 22, 1995) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and the private sector. This rule does not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

List of Subjects*24 CFR Part 401*

Grant programs-housing and community development, Housing, Housing assistance payments, Housing standards, Insured loans, Loan programs-housing and community development, Low and moderate income housing, Mortgage insurance, Mortgages, Rent subsidies, Reporting and recordkeeping requirements.

24 CFR Part 402

Housing, Housing assistance payments, Low and moderate income housing, Rent subsidies.

For the reasons set forth in the preamble, 24 CFR is amended by adding a new Chapter IV, which consists of parts 401 and 402, to read as follows:

CHAPTER IV—OFFICE OF MULTIFAMILY HOUSING ASSISTANCE RESTRUCTURING, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**PART 401—MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING PROGRAM (MARK TO MARKET).****PART 402—PROJECT-BASED SECTION 8 CONTRACT RENEWAL WITHOUT RESTRUCTURING UNDER SECTION 524 (a) OF MAHRA.****PART 401—MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING PROGRAM (MARK-TO-MARKET)****Subpart A—General Provisions; Eligibility Sec.**

- 401.1 What is the purpose of part 401?
- 401.2 What special definitions apply to this part?
- 401.99 What actions must an owner take to request a section 8 contract renewal?
- 401.100 Which projects are eligible for a Restructuring Plan under this part?
- 401.101 Which owners are ineligible for a Restructuring Plan?

Subpart B—Participating Administrative Entity (PAE) and Portfolio Restructuring Agreement (PRA)

- 401.200 Who may be a PAE?
- 401.201 How does HUD select PAEs?
- 401.300 What is a PRA?
- 401.301 Business arrangements.
- 401.302 PRA administrative requirements.
- 401.303 PRA indemnity provisions for SHFAs and HAS.
- 401.304 PRA provisions on PAE compensation.
- 401.307 On-going responsibility of PAE.
- 401.309 PRA term and termination provisions; other remedies.
- 401.310 Conflicts of interest.
- 401.311 Standards of conduct.
- 401.312 Confidentiality of information.
- 401.313 Consequences of PAE violations; finality of HUD determination.
- 401.314 Environmental review responsibilities.

Subpart C—Restructuring Plan

- 401.400 Required elements of a Restructuring Plan.
- 401.401 Consolidated Plans.
- 401.402 Cooperation with owner and qualified mortgagee in Restructuring Plan development.
- 401.403 Rejection of a request for a Restructuring Plan because of actions or omissions of owner or affiliate or project condition.
- 401.404 Proposed Restructuring Commitment.
- 401.405 Restructuring Commitment review and approval by HUD.
- 401.406 Execution of Restructuring Commitment.
- 401.407 Closing conducted by PAE.
- 401.408 Affordability and use restrictions required.
- 401.410 Standards for determining comparable market rents.

- 401.411 Guidelines for determining exception rents.
- 401.412 Adjustment of rents with operating cost adjustment factor (OCAF).
- 401.420 When must the Restructuring Plan require project-based assistance?
- 401.421 Rental Assistance Assessment Plan.
- 401.450 Owner evaluation of physical condition.
- 401.451 PAE Physical Condition Analysis (PCA).
- 401.452 Property standards for rehabilitation.
- 401.453 Housing quality standards.
- 401.460 Modification or refinancing of first mortgage.
- 401.461 HUD-held second mortgage.
- 401.471 HUD payment of a section 541(b) claim.
- 401.472 Rehabilitation funding.
- 401.473 HUD grants for rehabilitation under section 236(s) of NHA.
- 401.474 Project accounts.
- 401.480 Voluntary sale or transfer of project.
- 401.481 Subsidy layering limitations on HUD funds.
- 401.483 Leasing units to certificate and voucher holders.
- 401.484 Property management standards.
- 401.500 Required notices to third parties.
- 401.501 Who is entitled to receive notices under § 401.500?

Subpart D—Implementation of the Restructuring Plan After Closing

- 401.550 Monitoring and compliance agreements.
- 401.552 Servicing of second mortgage.
- 401.554 Contract administration.

Subpart E—Section 8 Requirements for Restructured Projects

- 401.595 Contract and regulatory provisions.
- 401.600 Will a section 8 contract be extended if it would expire while an owner's request for a Restructuring Plan is pending?
- 401.601 Consideration of an owner's request to renew an expiring contract without a Restructuring Plan.
- 401.602 Tenant protections if an expiring contract is not renewed.
- 401.605 Project-based assistance provisions.
- 401.606 Tenant-based assistance provisions.
- 401.607 Contract term.

Subpart F—Owner Dispute of Rejection and Administrative Appeal

- 401.645 How does the owner dispute a notice of rejection?
- 401.650 When may the owner make an administrative appeal of a final decision under this subpart?
- 401.651 Appeal procedures.
- 401.652 No judicial review.

Authority: 12 U.S.C. 1715z-1 and 1735f-19(b); 42 U.S.C. 1437f note and 3535(d).

Subpart A—General Provisions; Eligibility**§ 401.1 What is the purpose of part 401?**

This part contains the regulations implementing the authority in the

Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) for the Mark-to-Market Program including the renewal of project-based assistance contracts for eligible projects without restructuring. Section 511(b) of MAHRA details the purposes, and section 512(2) details the scope, of the Program.

§ 401.2 What special definitions apply to this part?

(a) *MAHRA* means the Multifamily Assisted Housing Reform and Affordability Act of 1997, title V of Pub. L. 105-65, 42 U.S.C. 1437f note.

(b) *Statutory terms.* Terms defined in section 512 of MAHRA are used in this part in accordance with their statutory meaning. These terms are: comparable properties, expiring contract, expiration date, fair market rent, mortgage restructuring and rental assistance sufficiency plan, nonprofit organization, qualified mortgagee, portfolio restructuring agreement, participating administrative entity, project-based assistance, renewal, State, tenant-based assistance, and unit of general local government.

(c) *Other terms.* As used in this part, the term—

Affiliate means an affiliate of the owner or an affiliate of the purchaser, as such terms are defined in section 516(a) of MAHRA.

Applicable Federal rate has the meaning given in section 1274(d) of the Internal Revenue Code of 1986.

Community-based nonprofit organization means a non-profit organization that maintains at least one-third of its governing board's membership for low-income residents from the local community, or for elected representatives of community organizations that represent low-income residents.

Comparable market rents has the meaning given in § 401.410(b).

Disabled family has the meaning given in § 5.403(b) of this title.

Elderly family has the meaning given in § 5.403(b) of this title.

Eligible project means a project with a mortgage insured or held by HUD, project-based assistance expiring on or after October 1, 1998, and rents for assisted units exceeding comparable market rents; and otherwise meeting the definition of "eligible multifamily housing project" in section 512(2) of MAHRA.

HUD means the Director of the Office of Multifamily Housing Assistance Restructuring (OMHAR) or a HUD official authorized to act in lieu of the Director, when used in reference to provisions of MAHRA that give

responsibilities to the Director, and otherwise has the meaning given in § 5.100 of this title.

NHA means the National Housing Act, 12 U.S.C. 1702 *et seq.*

Owner means the owner of a project and any purchaser of the project.

PAE means a participating administrative entity as defined in section 512(10) of MAHRA, or HUD when appropriate in accordance with section 513(b)(4) of MAHRA.

PCA means a physical condition assessment of a project prepared by a PAE under § 401.451.

PRA means a portfolio restructuring agreement as defined in section 512(9) of MAHRA.

Priority purchaser means a purchaser meeting qualifications established by HUD that is:

(1) A tenant organization or

(2) A tenant-endorsed community-based nonprofit organization or public agency.

Rental Assistance Assessment Plan means the plan described in section 515(c)(2) of MAHRA.

Restructured rent means the rent determined at the time of restructuring in accordance with section 514(g) of MAHRA.

Restructuring Plan means the Mortgage Restructuring and Rental Assistance Sufficiency Plan described in section 514 of MAHRA.

Section 8 means section 8 of the United States Housing Act of 1937, 42 U.S.C. 1437f.

Section 541(b) claim means a claim paid by HUD under an insurance contract under authority of section 541(b) of the National Housing Act, 12 U.S.C. 1735f-19(b).

Tenant organization means an organization that meets regularly, whose officers are elected by a majority of heads of households of occupied units, and whose membership is open to all tenants of a project.

Unit of local government means the smallest unit of general local government in which the project is located.

§ 401.99 What actions must an owner take to request a section 8 contract renewal?

(a) *Requesting Restructuring Plan.* An owner may request a section 8 contract renewal as part of a Restructuring Plan by, at least 3 months before the expiration date of any project-based assistance or as soon as practicable if the contract will expire before January 13, 1999, certifying to HUD that to the best of the owner's knowledge:

(1) Project rents are above comparable market rents; and

(2) Neither the owner nor any affiliate is suspended or debarred, or, if so, a

voluntary sale transfer of the property is proposed in accordance with § 401.480.

(b) *Eligible but not requesting Restructuring Plan.* If an owner is eligible for a Restructuring Plan but requests a renewal of project-based assistance without a Plan, HUD will consider the request, in accordance with § 401.601 if, at least 3 months before the expiration date of any project-based assistance or as soon as practicable if the contract will expire before January 1, 1999, an owner provides to HUD the certification required in paragraph (a) of this section, and the following additional information:

(1) A comparable market rent analysis;

(2) The prior fiscal year's audited financial statement for the project;

(3) An owner's evaluation of physical condition as provided in § 401.450; and

(4) Such other documents as the PAE or HUD may require.

(c) *Not eligible for Restructuring Plan.* Section 402.5 of this chapter addresses renewal of project-based assistance for a project not eligible for a Restructuring Plan.

§ 401.100 Which projects are eligible for a Restructuring Plan under this part?

General eligibility. A Restructuring Plan may be requested by an owner of an eligible project that:

(a) Has project-based assistance with an expiration date of October 1, 1998, or later;

(b) Has current gross potential rent for the project-based assisted units that exceeds the gross potential rent for the project based assisted units using comparable market rents; and

(c) Is not described in section 514(h) of MAHRA.

§ 401.101 Which owners are ineligible for a Restructuring Plan?

The request of an owner of an eligible project for a Restructuring Plan will not be considered if the owner or an affiliate is debarred or suspended under part 24 of this title, unless a sale or transfer of the property is proposed in accordance with § 401.480.

Subpart B—Participating Administrative Entity (PAE) and Portfolio Restructuring Agreement (PRA)

§ 401.200 Who may be a PAE?

A PAE must qualify under the definition in section 512(10) of MAHRA. It must not have any outstanding violations of civil rights laws, determined in accordance with criteria in use by HUD. If the PAE is a private entity, whether nonprofit or for-profit, it must enter into a partnership

with a public purpose entity, which may include HUD. The formed entity must meet all legal requirements for a partnership. A PAE may delegate responsibilities only as stated in the PRA.

§ 401.201 How does HUD select PAEs?

(a) *Selection of PAE.* HUD will select qualified PAEs in accordance with the criteria established in 513(b) of MAHRA and criteria established by HUD. The selection method is within HUD's discretion, including but not limited to a request for qualifications.

(b) *Priority for public agencies.* HUD will provide a one-time priority period for State Housing Finance Agencies and local housing agencies to qualify as the PAEs for their jurisdictions. If more than one agency qualifies for the same jurisdiction, HUD will provide an opportunity for the agencies to allocate responsibility for projects in the jurisdiction. If the agencies are unable to agree, HUD will choose a PAE in accordance with section 513(b)(2) of MAHRA.

(c) *Qualification for PAE by nonprofit and for profit entities.* After the priority period expires, HUD will consider other eligible entities as PAEs for jurisdictions in which no public agency has qualified as the PAE, or for projects that have not been assigned to a qualified public agency.

(d) *No PAE for project.* If HUD does not select a PAE for a project, HUD may perform the functions of the PAE, or contract with other qualified entities to perform those functions.

§ 401.300 What is a PRA?

A PRA is an agreement between HUD and a PAE that delineates rights and responsibilities in connection with development and implementation of a Restructuring Plan. The PRA must contain the matters required by section 513(a)(2) of MAHRA, and §§ 401.301 through 401.309, as well as other terms and conditions required by HUD.

§ 401.301 Business arrangements.

If the PAE is in a partnership, the PRA must specify the following:

(a) The responsibilities of each partner regarding the Restructuring Plan;

(b) The resources each partner will provide to accomplish its designated responsibilities; and

(c) All compensation to each partner, whether direct or indirect.

§ 401.302 PRA administrative requirements.

(a) *Inapplicability of certain requirements.* Parts 84 and 85 of this

title and contract procurement requirements do not apply to a PRA.

(b) *Recordkeeping.* The PAE must keep complete and accurate records of all activities related to the PAE's performance under the PRA. The PAE must retain the records for at least 3 years after the PRA terminates.

(c) *Inspection of records and audit.* Upon reasonable notice, the PAE must permit the Comptroller General of the United States and HUD (including representatives of the HUD Office of Inspector General) to inspect, audit and copy any records required to be retained under this section.

401.303 PRA indemnity provisions for SHFAs and HAs.

When a PRA requires HUD to indemnify a PAE in accordance with section 513(a)(2)(G) of MAHRA, any payment under this indemnity is contingent upon the availability of funds that are permitted by law to be used for this purpose.

§ 401.304 PRA provisions on PAE compensation.

(a) *Base fee.* The PRA will provide for a base fee to be paid by HUD.

(b) *Incentives.* The PRA may provide for incentives to be paid by HUD for achievement of stated objectives.

(c) *Expenses.* The PRA will identify expenses incurred by the PAE that will qualify for reimbursement by HUD.

§ 401.307 On-going responsibility of PAE.

The PRA must provide for on-going activities necessary to implement the Restructuring Plan after the closing under § 401.407.

§ 401.309 PRA term and termination provisions; other remedies.

(a) *1-year term with renewals.* The PRA will have a term of 1 year, to be renewed for successive terms of 1 year with the mutual agreement of both parties. The PRA will provide for HUD to pay final compensation to the PAE and to assign responsibility for continuing activities if the PRA is not renewed.

(b) *Termination for cause.* A PRA will be subject to termination by HUD at any time for cause, with payment required by HUD as provided in the PRA only for matters performed by the PAE to the date of termination. When cause for termination exists, HUD may order an immediate transfer of some or all of the PAE's duties to another PAE designated by HUD. HUD may temporarily waive its right of immediate termination for cause in order to allow an orderly transfer of duties and responsibilities under a PRA, without waiving the right of termination after the transfer has been

completed to HUD's satisfaction. HUD will retain the right of set-off against any payments due as well as such other rights afforded at law and in equity.

(c) *Liability for damages.* During the term of a PRA, or notwithstanding any termination of a PRA, HUD may seek its actual, direct, and consequential damages from any PAE failure to comply with its obligations under the PRA.

(d) *Cumulative remedies.* The remedies under this section are cumulative and in addition to any other remedies or rights HUD may have under the terms of the PRA, at law, or otherwise.

§ 401.310 Conflicts of interest.

(a) *Definitions.* (1) *Conflict of interest.* A conflict of interest is a situation in which a PAE or other restricted person has:

(i) A financial interest in a matter relating to the PRA;

(ii) One or more personal, business, or financial interests or relationships which would cause a reasonable person with knowledge of the relevant facts to question the integrity or impartiality of those who are or will be acting under the PRA; or

(iii) Is taking an adverse position to HUD or to an owner whose project is covered by a PRA in a lawsuit, administrative proceeding or other contested matter.

(2) *Control* means the power to vote, directly or indirectly, 25 percent or more of any class of the voting stock of a company; the ability to direct in any manner the election of a majority of a company (or other entity's) directors or trustees; or the ability to exercise a controlling influence over the company or entity's management and policies. For purposes of this definition, a general partner of a limited partnership is presumed to be in control of that partnership.

(3) *Restricted person* means a PAE; any management official of the PAE; any legal entity that is under the control of the PAE, is in control of the PAE or is under common control with the PAE; or any employee, agent or contractor of the PAE, or employee of such agent or contractor, who will perform or has performed services under a PRA with HUD.

(b) *General prohibitions.* (1) The PAE may not permit conflicts of interest to exist without obtaining a waiver in accordance with this section.

(2) The PAE must establish procedures to identify conflicts of interest and to ensure that conflicts of interest do not arise or continue, subject

to waiver under paragraph (c) of this section.

(3) HUD will not enter into PRAs with potential PAEs who have conflicts of interest associated with a particular project, or permit PAEs to continue performance under existing PRAs when such PAEs have conflicts of interest, unless such conflicts have been eliminated to HUD's satisfaction by the PAE or potential PAE or are waived by HUD.

(4) The PAE has a continuing obligation to take all action necessary to identify whether it or any other restricted person has a conflict of interest.

(c) *Waivers.* HUD will waive conflicts of interest only when, in light of all relevant circumstances, the interests of HUD in the PAE's or another restricted persons's participation outweigh the concern that a reasonable person may question the integrity of HUD's operations.

(d) *Conflicts of interest arising prior to PAE selection.* (1) *Request for review of conflicts of interest.* (i) A potential PAE, with its request to HUD for consideration for selection as a PAE, must identify existing conflicts of interest and may make a written request for a determination as to the existence of a conflict of interest, may request that the conflict of interest, if any, be waived, or may propose how it could eliminate the conflict.

(ii) If, after submitting a request but prior to selection, a potential PAE discovers that it has a conflict, it must notify HUD in writing within 10 days of submitting the request or prior to selection, whichever is earlier. The potential PAE may, with its notices, request that the conflict be waived or may propose how it may eliminate the conflict. The potential PAE may also request a determination as to the existence of the conflict.

(2) *Review by HUD.* Subject to the restrictions set forth in this section, HUD in its sole discretion may determine whether a conflict of interest exists, may waive the conflict of interest, or may approve in writing a PAE's proposal to eliminate a conflict of interest.

(e) *Conflicts of interest that arise or are discovered after PAE selection.* (1) A PAE must notify HUD in writing within 10 days after discovering that it or another restricted person has a conflict of interest. Such notification must contain a detailed description of the conflict of interest and state how the PAE intends to eliminate the conflict. The PAE may also request a determination as to the existence of a conflict.

(2) HUD will, after receipt of such notification or other discovery of the PAE's conflict or potential conflict of interest, take such action as it determines is in its best interests, which may involve proceeding under § 401.313 or as provided in paragraph (e)(2) of this section. HUD may notify the PAE in writing of its findings as to whether a conflict of interest exists and the basis for such determination, whether or not a waiver will be granted, or whether corrective actions may be taken in order to eliminate the conflict of interest. Corrective action must be completed by the PAE not later than 30 days after notification is mailed by HUD unless HUD, at its sole discretion, determines that it is in its best interests to grant the PAE an extension in which to complete the corrective action.

(f) *Reconsideration of decisions.* Decisions issued pursuant to this section may be reconsidered by HUD upon application by the PAE. Such requests must be in writing and must contain the basis for the request. HUD may, at its discretion and after determining that it is in its best interests, stay any corrective or other actions previously ordered pending reconsideration of a decision.

§ 401.311 Standards of conduct.

(a) *Minimum ethical standards for PAEs.* In connection with the performance of any PRA and during the term of such PRA, a PAE or other restricted person (as defined in § 401.310) may not:

(1) Solicit for itself or others favors, gifts, or other items of monetary value from any person who is seeking official action from HUD or the PAE in connection with the PRA or has interests which may be substantially affected by the restricted person's performance or nonperformance of duties to HUD;

(2) Use improperly or allow the improper use of HUD property, or property over which the restricted person has supervision or charge by reason of the PRA;

(3) Use its status as PAE for its own benefit, or the financial or business benefit of a third party, except as contemplated by the PRA; or

(4) Make any unauthorized promise or commitment on behalf of HUD.

(b) *18 U.S.C. 201.* Pursuant to 18 U.S.C. 201, whoever acts for or on behalf of HUD in connection with the matters covered by this part is deemed to be a public official. Public officials are prohibited from soliciting or accepting anything of value in return for being influenced in the performance of

official actions. Violators are subject to criminal sanctions.

(c) *18 U.S.C. 1001.* Pursuant to 18 U.S.C. 1001, whoever knowingly and willingly falsifies a material fact, makes a false statement or utilizes a false writing in connection with a PRA is subject to criminal sanctions. Other Federal civil statutes also apply to making false statements to the United States.

(d) *18 U.S.C. 207.* Former government employees are subject to the prohibitions found at 18 U.S.C. 207.

§ 401.312 Confidentiality of information.

A PAE and every other restricted person (as defined in § 401.310) has a duty to protect confidential information and to prevent its use to further a private interest other than as contemplated by the PRA. As used in this section, confidential information means information that a PAE or other restricted person obtains from or on behalf of HUD or a third party in connection with a PRA but does not include information generally available to the public unless the information becomes available to the public as a result of unauthorized disclosure by the PAE or another restricted person.

§ 401.313 Consequences of PAE violations; finality of determination.

(a) *Effect on PRA.* If a PAE, potential PAE or other restricted person (as defined in § 401.310) violates §§ 401.310, 410.311, or 401.312, HUD may:

(1) Find the PAE unqualified to enter into a PRA, or unqualified to receive additional projects for restructuring under an existing PRA;

(2) Find the PAE in default under an existing PRA with the right of termination for cause under § 401.309; or

(3) Seek its actual, direct, and consequential damages from a PAE whose conflicts of interest, failure to comply with confidentiality requirements, or failure to comply with the minimum ethical standards for PAEs that were the basis for termination of a PRA.

(b) *Cumulative remedies.* The remedies under this section are cumulative and in addition to any other remedies or rights HUD may have under the terms of the PRA, at law, or otherwise.

(c) *Finality of determination.* Any determination made by HUD pursuant to this section is at HUD's sole discretion and is not subject to further administrative review.

§ 401.314 Environmental review responsibilities.

HUD will retain all responsibility for environmental review under part 50 of this title. Any required review will be completed before any HUD execution of the Restructuring Commitment under § 401.405.

Subpart C—Restructuring Plan**§ 401.400 Required elements of a Restructuring Plan.**

(a) *General.* A PAE is responsible for the development of a Restructuring Plan for each project included in its PRA.

(b) *Required elements.* The Restructuring Plan must contain a narrative that fully describes the restructure transaction. The Restructuring Plan must include the elements required at Section 514 of MAHRA. The Restructuring Plan must describe the use of any restructuring tools listed at section 517(a) and (b) of MAHRA, and must contain other requirements as determined by HUD.

§ 401.401 Consolidated Plans.

A PAE may request HUD to approve a Consolidated Restructuring Plan that presents an overall strategy for more than one project included in the PRA. HUD will consider approval of a Consolidated Restructuring Plan for projects having common ownership, geographic proximity, common mortgagee or servicer, or other factors that contribute to more efficient use of the PAE's resources. Notwithstanding the more efficient use of a PAE's resources, HUD will not approve any Consolidated Restructuring Plans that have a detrimental effect on tenants or the community, or a higher cost to the Federal government.

§ 401.402 Cooperation with owner and qualified mortgagee in Restructuring Plan development.

A PAE must comply with section 514(a)(2) of MAHRA by using its best efforts to seek the cooperation of the owner and qualified mortgagee or its designee in the development of the Restructuring Plan. If the owner fails to cooperate to the satisfaction of the PAE and HUD agrees, the PAE must notify the owner that the PAE will not develop a Restructuring Plan. This notice will be a final decision subject to dispute and administrative appeal under subpart F of this part. If the qualified mortgagee does not cooperate in modifying the mortgage, the PAE and owner may continue to develop a Restructuring Plan to restructure the loan using alternative financing.

§ 401.403 Rejection of a request for a Restructuring Plan because of actions or omissions of owner or affiliate or project condition.

(a) *Ongoing determination of owner and project eligibility.* Notwithstanding an initial determination to accept the owner's request for a Restructuring Plan, the PAE is responsible for a further more complete and ongoing assessment of the eligibility of the owner and project while the Restructuring Plan is developed. The PAE must advise HUD if at any time any of the grounds for rejection listed in paragraph (b) of this section exist.

(b) *Grounds for rejection.* HUD may elect not to permit continued consideration of the Restructuring Plan if at any time before closing under § 401.407:

(1) The owner or an affiliate is debarred or suspended under part 24 of this title;

(2) HUD or the PAE determines that the owner or an affiliate has engaged in material adverse financial or managerial actions or omissions as described at section 516(a) and (b) of MAHRA, including any outstanding violations of civil rights laws in connection any project of the owner or affiliate; or

(3) HUD or the PAE determines that the project does not meet the housing quality standards in § 401.453 and that the poor condition of the project is not likely to be remedied in a cost-effective manner through the Restructuring Plan.

(c) *Dispute and appeal.* An owner may dispute a rejection under this section and seek administrative review under the procedures in subpart F of this part.

§ 401.404 Proposed Restructuring Commitment.

A PAE must submit a Restructuring Plan and a proposed Restructuring Commitment to HUD for approval, prior to submitting the Commitment to the owner for execution. The proposed Restructuring Commitment must be in a form approved by HUD, incorporate the Restructuring Plan, and include the following:

(a) The lender, loan amount, interest rate, and term of any mortgages or unsecured financing for the mortgage restructuring and rehabilitation, and any credit enhancement;

(b) The amount of any payment of a section 541(b) claim;

(c) The type of section 8 assistance and the section 8 restructured rents;

(d) The rehabilitation required, the source of the owner contribution, and escrow arrangements;

(e) The uses for project accounts;

(f) The terms of any sale or transfer of the project; and

(g) A schedule setting forth all sources and uses of funds to implement the Restructuring Plan, including setting forth the balances of project accounts before and after restructuring; and

(h) Other terms and conditions prescribed by HUD.

§ 401.405 Restructuring Commitment review and approval by HUD.

HUD will either approve the Restructuring Commitment as submitted, require changes as a condition for approval, or reject the Plan. If the Plan is rejected, HUD will inform the PAE of the reasons for rejection. HUD's rejection of the Plan is subject to the dispute and administrative appeal provisions of subpart F of this part.

§ 401.406 Execution of Restructuring Commitment.

When HUD approves the Restructuring Commitment, the PAE will deliver the Restructuring Commitment to the owner for execution. The Restructuring Commitment becomes binding upon execution by the owner. An owner who does not execute the Restructuring Commitment may appeal its terms and seek modification under subpart F of this part.

§ 401.407 Closing conducted by PAE.

After the owner has executed the Restructuring Commitment, the PAE must arrange for a closing to execute all documents necessary for implementation of the Restructuring Plan. The PAE must use standard documents approved by HUD, with modifications only as necessary to comply with applicable State or local laws, or such other modifications as are approved in writing by HUD.

§ 401.408 Affordability and use restrictions required.

(a) *General.* The Restructuring Plan must provide that the project will be subject to affordability and use restrictions in a Use Agreement acceptable to HUD. The Use Agreement must be recorded and in effect for at least 30 years. It must include at least the provisions required by this section.

(b) *Use restriction.* The project must continue to be used for residential use with no reduction in the number of residential units without prior HUD approval.

(c) *Affordability restrictions.* Except during a period when at least 20 percent of the units in a project receive project-based assistance:

(1) At least 20 percent of the units in the project must be leased to families whose adjusted income does not exceed 50 percent of the area median income as

determined by HUD, with adjustments for household size, at rents no greater than 30 percent of 50 percent of the area median income; or

(2) At least 40 percent of the units in the project must be leased to families whose adjusted income does not exceed 60 percent of the area median income as determined by HUD, with adjustments for household size, at rents no greater than 30 percent of 60 percent of the area median income.

(d) *Comparable configuration.* The type and size of the units that satisfy the affordability restrictions of paragraph (c) of this section must be comparable to the type and size of the units for the project as a whole.

(e) *Owner obligation to accept assistance.* Subject to the availability of appropriated funds, the owner of the project must accept any offer of project-based or tenant-based assistance renewal or extension so long as the offer is in accordance with the terms and conditions specified in the Restructuring Plan.

(f) *Reporting.* The Use Agreement must contain appropriate financial and other reporting requirements for the owner.

(g) *Enforcement and amendment.* The Use Agreement will be enforceable by interested parties to be specified in the Agreement, which may include HUD, the PAE, project tenants, organizations representing project tenants, and the unit of local government.

(h) *Modifications.* HUD will retain the right to approve modifications of the Use Agreement agreed to by the owner without the consent of any other party, including those having the right of enforcement.

§ 401.410 Standards for determining comparable market rents.

(a) *When are comparable market rents required?* The Restructuring Plan must establish restructured rents at comparable market rents unless the PAE finds that exception rents are necessary under § 401.411.

(b) *Comparable market rents defined.* Comparable market rents are the rents charged for properties that the PAE determines to be comparable properties as defined in section 512(1) of MAHRA, except that projects assisted under part 891 of this title may not be taken into account. For purposes of section 512(1), other relevant characteristics include any applicable rent control and other characteristics determined by the PAE.

(c) *Methodology for determining comparable market rents.* If the PAE is unable to identify at least three comparable properties within the local market, the PAE may:

(1) Use non-comparable housing stock within that market from which adjustments can be made; or

(2) If necessary to go outside the market, use comparable properties as far outside the local market as it finds reasonable, from which adjustments can be made.

(d) *Using FMR as last resort.* If the PAE is unable to identify enough properties under paragraph (c) of this section, the rents must be set at 90 percent of the Fair Market Rents for the relevant market area.

§ 401.411 Guidelines for determining exception rents.

(a) *When do exception rents apply? (1)* The Restructuring Plan may provide for exception rents established under section 514(g) of MAHRA if the PAE determines that project income under the rent levels established under § 401.410 would be inadequate to meet the costs of operating the project as described in paragraph (b) of this section and that the housing needs of the tenants and the community could not be adequately addressed.

(2) In any fiscal year, the PAE may not request HUD to approve Restructuring Plans with exception rents for more than 20 percent of all units covered by the PRA, except that HUD may approve a waiver of this 20 percent limitation based on the PAE's narrative explanation of special need.

(b) *How are exception rents calculated?* Exception rents must be set at a level sufficient to support the costs of operating the project. The PAE must take into account the cost items listed in section 514(g)(3)(A) through (E) of MAHRA, except that debt service is limited to payment of the second mortgage under § 401.461(a) or a rehabilitation loan included in the Restructuring Plan. The exception rent must not exceed 120 percent of the Fair Market Rent for the market area, except that HUD may approve an exception rent greater than 120 percent of Fair Market Rent, based on a narrative explanation of special need submitted by the PAE, subject to the 5 percent limitation in section 514(g)(2)(A) of MAHRA.

§ 401.412 Adjustment of rents with operating cost adjustment factor (OCAF).

(a) *OCAF required for Restructuring Plan.* The Restructuring Plan must provide for annual adjustment of the restructured rents by an OCAF determined by HUD and applied as provided in this section. An OCAF may be positive or negative.

(b) *Application of OCAF.* HUD will apply the OCAF to the previous year's

contract rent less the portion of that rent paid for debt service. Paragraph (b) of this section applies to renewals of contracts in subsequent years which receive restructured rents under either section 514(g)(1) or (2) of MAHRA.

§ 401.420 When must the Restructuring Plan require project-based assistance?

(a) *Criteria in MAHRA.* The Restructuring Plan must provide for the section 8 contract to be renewed as project-based assistance, subject to the availability of funds for this purpose, if the PAE determines that one or more of the circumstances described in section 515(c)(1)(A), (B), or (C) of MAHRA exists.

(b) *Meaning of "predominant".* For purposes of section 515(c)(1)(B), project has a predominant number of units occupied by elderly families, disabled families, or elderly and disabled families if at least 50 percent of the units are occupied by these families.

(c) *Tight rental market.* The conditions of section 515(c)(1)(A) are met if the PAE determines that there is a market-wide vacancy rate of 6 percent or less.

§ 401.421 Rental Assistance Assessment Plan.

(a) *Plan required.* For any project not subject to mandatory project-based assistance under § 401.420, the PAE must develop a Rental Assistance Assessment Plan in accordance with section 515(c)(2) of MAHRA to determine whether assistance should be renewed as project-based assistance or whether some or all of the assisted units should be converted to tenant-based assistance.

(b) *Matters to be assessed.* The PAE must consider the cost of providing assistance, comparing the applicable payment standard for tenant-based assistance to the project's adjusted rent levels determined under § 401.410 or § 401.411. In addition, the PAE must consider the other matters listed in section 515(c)(2)(B) of MAHRA to be assessed as part of the Plan, and the applicable Consolidated Plan developed under part 91 of this title.

(c) *Conversion may be phased in.* Any conversion from project-based assistance to tenant-based assistance may occur over a period of not more than 5 years if the PAE decides the transition period is needed for the financial viability of the project.

(d) *Reports to HUD.* The PAE must report to HUD on the matters specified in section 515(c)(2)(C) of MAHRA at least semi-annually.

§ 401.450 Owner evaluation of physical condition.

(a) *Initial evaluation.* The owner must evaluate the physical condition of the project and provide the following information to the PAE in a form acceptable to the PAE:

(1) All work items required to bring the project to the standard in § 401.452;

(2) The capital repair or replacement items that will be necessary to maintain the long-term physical integrity of the property;

(3) A plan for funding the rehabilitation work included in paragraph (a)(1) of this section, which work must be completed in a timely manner after closing the restructuring transaction, that identifies the source of the required owner contribution of non-project funds; and

(4) An estimate of the initial deposit, if any, and the estimated monthly deposit to the reserve for replacement account for the next 20 years.

(b) *Reconsideration and modification of evaluation.* If the PAE, after its independent review under § 401.451, determines that the owner's evaluation either fails to address specific necessary work items or fails to propose a cost-effective approach to rehabilitation, the owner may modify its evaluation to satisfy the concerns of the PAE.

§ 401.451 PAE Physical Condition Analysis (PCA).

(a) *Review and certification of owner evaluation.* (1) The PAE must independently evaluate the physical condition of the project by means of a PCA. If the PAE finds any immediate threats to health and safety, the owner must complete those work items immediately, or the PAE must evaluate the project's eligibility in accordance with § 401.403(b)(3).

(2) After consultation with the owner and an opportunity for the owner to modify its evaluation performed under § 401.450, the PAE must certify to the accuracy and completeness of the owner's evaluation performed under § 401.450 for each project covered by the PRA or state that the evaluation fails to address certain items or does not propose a cost effective approach.

(b) *Rejection for inaccurate or incomplete owner evaluation.* If the PAE cannot certify to the accuracy and completeness of the owner's evaluation due to its failure to address specific work items or because it does not propose a cost effective approach, the PAE must notify HUD. If HUD agrees with the PAE's determination, the PAE must notify the owner that the request for a Restructuring Plan is rejected.

(c) *Rejection for lack of cost-effectiveness.* Based on the completed PCA, the PAE must determine whether proceeding with a Restructuring Plan with necessary rehabilitation is more cost-effective in terms of Federal resources than rejecting the Request for a Restructuring Plan under § 401.403(b)(3) and providing tenant-based assistance for displaced tenants under § 401.602. HUD will provide guidance to PAEs for making the cost-effectiveness determination. If the PAE concludes that a request for a Restructuring Plan should be rejected because of lack of cost-effectiveness, it must also consider the effect on tenants and the community and advise HUD of the effect.

(d) *Dispute and appeal of rejection.* The dispute and appeal provisions of subpart F of this part apply to rejections under paragraphs (b) and (c) of this section.

§ 401.452 Property standards for rehabilitation.

The Restructuring Plan must provide for the level of rehabilitation needed to restore the property to the non-luxury standard adequate for the rental market for which the project was originally approved. If the standard has changed over time, the rehabilitation may include improvements to meet current standards. The result of the rehabilitation should be a project that can attract non-subsidized tenants but competes on rent rather than on amenities. When a range of options exists for satisfying the rehabilitation standard or the plan for capital replacement, the PAE must choose the least costly option considering both capital and operating costs and taking into account the remaining useful life of all building systems. Nothing in this part exempts rehabilitation from the requirements of part 8 of this title concerning accessibility to persons with disabilities.

§ 401.453 Housing quality standards.

(a) *Standards.* The Restructuring Plan must require the owner to maintain the project, for the duration of the Use Agreement under § 401.408, in a decent and safe condition that meets the applicable standards under this section. As long as project-based assistance is provided, the applicable standards are the physical conditions standards for HUD housing in § 5.703 of this title. At any other time, the applicable standards are the local housing codes or codes adopted by the public housing agency if such codes meet or exceed the standards in § 5.703 of this title and do not severely restrict housing choice or, if

there are no such local housing codes or codes adopted by the public housing agency, the standards in § 5.703 will apply. In addition, any unit in which the tenant receives tenant-based assistance must comply with the housing quality standards of the section 8 tenant-based programs.

(b) *Reserves.* The Restructuring Plan must also provide for reserves for capital replacement sufficient to assure the property's long term structural integrity so that the property can be maintained as affordable housing in decent and safe condition meeting the standards of this section.

§ 401.460 Modification or refinancing of first mortgage.

(a) *Principal amount.* As part of the Restructuring Plan, the PAE will determine the size of the restructured first mortgage that will result from the modification or refinancing of the existing FHA-insured or HUD-held first mortgage. The restructured first mortgage must be in the amount that can be supported by net operating income based on the lower of the restructured section 8 rents or the rents allowed by the Use Agreement under § 401.408. Neither the outstanding principal balance of the existing first mortgage, nor the monthly principal and interest payments on that debt, may be increased through the Restructuring Plan. The debt service coverage used by the PAE must be adequate for purposes of the Restructuring Plan and for the requirements of any refinancing.

(b) *Fully amortizing.* The modified or refinanced first mortgage must be fully amortizing through level monthly payments.

(c) *Rates and other terms.* Interest rates and other terms of the modified or refinanced first mortgage must be competitive in the market.

(d) *Fees.* Any fees or costs associated with mortgage modification or refinancing determined by the PAE to be above normal processing fees must be paid by the owner from non-project funds and must not be included in the modified or refinanced first mortgage.

(e) *Refinancing.* (1) If the holder of the existing FHA-insured first mortgage does not agree to modify and re-amortize the outstanding loan, the loan must be refinanced.

(2) The refinancing may be either without credit enhancement or with credit enhancement under one of the following:

(i) *FHA mortgage insurance.* If the Restructuring Plan provides for FHA mortgage insurance for the refinanced first mortgage, the insurance will be provided in accordance with all usually

applicable FHA legal requirements except that insurance will be documented as provided in section 517(b)(2) of MAHRA. HUD will issue the commitment for mortgage insurance but may adapt its procedures as necessary to facilitate development and implementation of a Restructuring Plan.

(ii) *Other FHA credit enhancement.* If FHA credit enhancement, including risk-sharing, is provided under part 266 of this title, the credit enhancement will be provided in accordance with all usually-applicable FHA legal requirements under part 266 of this title, except that special approval from HUD will be required before the PAE engages in risk-sharing with FHA under part 266 of this title.

(iii) *Credit enhancement from non-FHA sources.* If credit enhancement is to be provided by a non-FHA source under section 517(b)(4) of MAHRA, HUD will consider waiver of any non-statutory provision in this part only if the waiver will not materially impair achievement of the purposes of MAHRA and if the waiver is essential to meet the legitimate business or legal requirements of the provider of credit enhancement.

§ 401.461 HUD-held second mortgage.

(a) *Amount.* If the Restructuring Plan provides for payment of a section 541(b) claim, the Plan must also provide for a second mortgage to HUD in an amount that does not exceed the amount that the PAE reasonably expects to be repaid based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the project. The second mortgage also must not exceed the difference between the unpaid principal balance on the first mortgage immediately before and after restructuring.

(b) *Terms and conditions.* (1) The second mortgage must have an interest rate of at least 1 percent, but not more than the applicable Federal rate. Interest will accrue but not compound.

(2) The second mortgage must have a term concomitant with the modified or refinanced first mortgage. HUD may provide that if the first mortgage of a nominal amount is satisfied, the second mortgage may continue for a term established by HUD.

(3)(i) Principal and interest on the second mortgage is payable only out of net cash flow during its term. "Net cash flow" means that portion of project income that remains after the payment of all required debt service payments on the modified or refinanced first mortgage, if any, including payment of any past due principal or interest, and payment of all reasonable and necessary

operating expenses (including deposits to the reserve for replacement account) and any other expenditure approved by HUD.

(ii) The priority and distribution of net cash flow is as follows:

(A) HUD or the PAE may approve the payment to the owner of up to 25 percent of net cash flow based on consideration of relevant conditions and circumstances including, but not limited to, the project management meeting the management standards prescribed in § 401.484 and the project meeting the housing quality standards prescribed in § 401.453; and

(B) All remaining net cash flow will be applied to the principal and interest on the second mortgage, until paid in full, and then to any additional subordinate mortgage under § 401.461(c).

(4) HUD may cause the second mortgage to be immediately due and payable on the grounds provided in section 517(a)(4) of MAHRA, including an assumption of the mortgage in violation of HUD standards for approval of transfers of physical assets (if applicable), or the owner fails to comply with other HUD requirements after a reasonable opportunity for the owner to cure such failure. A decision by HUD in this regard is subject to the administrative appeals procedure in subpart F of this part.

(5) HUD will consider modification or forgiveness of all or part of the second mortgage only if the project has been sold or transferred to a priority purchaser under § 401.480 and HUD determines that modification or forgiveness is necessary to recapitalize the project in order to preserve it as affordable housing.

(c) *Additional mortgage to HUD.* If the amount of a section 541(b) claim under § 401.471 exceeds the principal amount of the second mortgage, a Restructuring Plan may require the owner to give an additional mortgage on the project to HUD to secure repayment of that portion of the claim that is not already secured. This additional mortgage must be junior in priority to the second mortgage required by paragraph (a) of this section, bear interest at the same rate which will accrue but not compound, and require no payments except payment in full when the second mortgage is satisfied.

§ 401.471 HUD payment of a section 541(b) claim.

HUD will pay a section 541(b) claim from the appropriate insurance fund to the insured mortgagee on behalf of the mortgagor to reduce the principal balance of the insured mortgage as

provided in the Restructuring Plan. All section 541(b) claims will be paid in cash. Part 207 of this title and sections 207(g) and 541(a) of the NHA do not apply to a section 541(b) claim.

§ 401.472 Rehabilitation funding.

(a) *Sources of funds.* (1) *Project accounts.* The Restructuring Plan for funding rehabilitation must include funds from the project's residual receipts account, surplus cash account, residual receipts account and other project accounts, to the extent the PAE determines that those accounts will not be needed for the initial deposit to the reserves.

(2) *Debt restructuring.* The Restructuring Plan may provide for funding of rehabilitation through a new first mortgage in conjunction with a payment of a section 541(b) claim. The payment of claim may be in an amount necessary to facilitate the funding of the rehabilitation, by reducing the existing first mortgage debt to make refinancing proceeds available to fund rehabilitation.

(3) *Section 236(s) rehabilitation grant.* The Restructuring Plan may include a direct grant from HUD under section 236(s) of the NHA to cover a portion of the rehabilitation cost, to the extent that HUD has determined that funding is available for such a grant.

(4) *Section 8 budget authority increase.* The Restructuring Plan may include funding of rehabilitation from budget authority provided to HUD for increases in section 8 contracts, to the extent that HUD has determined that funding from this source is available.

(b) *Statutory restrictions.* Any rehabilitation funded from the sources described in paragraph (a) of this section is subject to the requirements in section 517(b)(7) of MAHRA for an owner contribution. The required owner contribution will be calculated as 20 percent of the total cost of rehabilitation, unless it is determined that a higher percentage is required. The PAE may exempt housing cooperatives from the owner contribution requirement.

(c) *Escrow agent.* The Restructuring Plan must provide for progress payments for rehabilitation, which must be disbursed by an acceptable escrow agent subject to PAE oversight or as otherwise provided by HUD.

§ 401.473 HUD grants for rehabilitation under section 236(s) of NHA.

HUD will consider a direct grant for rehabilitation under section 236(s) of the NHA only if the owner provides an acceptable work schedule and cost-analysis that is consistent with the

owner's evaluation of physical condition under § 401.450, as certified by the PAE. The owner must execute a grant agreement with terms and conditions acceptable to HUD. If the PAE is a State or local government, or an agency or instrumentality of such a government, the PAE and HUD may agree that the PAE will be delegated the responsibility for the administration of any grant made under § 401.473, if HUD has determined that funding for the cost of grant administration is available.

§ 401.474 Project accounts.

(a) *Accounts from other projects.* The accounts listed in 401.472(a)(1) may be used for other eligible projects only if:

(1) The projects are included in a Consolidated Restructuring Plan under § 401.401; and

(2) The funds are used for rehabilitation or to reduce a section 541(b) claim paid by HUD under § 401.471.

(b) *Distribution to owner.* The Restructuring Plan may provide for a one-time distribution to the owner, not to exceed 10 percent of the excess funds in project accounts, after completion of the rehabilitation required by the Restructuring Plan.

§ 401.480 Voluntary sale or transfer of project.

(a) *May the owner request a Restructuring Plan that includes a sale or transfer of the property?* The owner may request a Restructuring Plan that includes a condition that the property be sold or transferred to a purchaser acceptable to HUD in a reasonable period to consummate the transaction. The failure to consummate a sale or transfer of the property requested under paragraph (a) of this section will neither adversely affect an owner's eligibility for a Restructuring Plan nor exempt the owner from the requirements of § 401.600.

(b) *When must the Restructuring Plan include a sale or transfer of the property?* If the owner is determined ineligible pursuant to § 401.101 or § 401.403, the Restructuring Plan must include a condition that the owner sell or transfer the property to a purchaser acceptable to HUD.

(c) *Owner's notice of intent to sell or transfer.* If a sale or transfer is required under paragraph (b) of this section:

(1) The owner must provide notice to the PAE affirming the owner's intent to sell or transfer the property. This notice must be received by the PAE no later than 30 days after a notice of rejection under § 401.101 or § 401.403 has become a final determination under subpart F of this part.

(2) The owner must cooperate in selling or transferring the property. Failure to do so will result in the PAE's determination to reject the owner's request for a Restructuring Plan. The owner must distribute and publish, in an appropriate publication, a notice to potential purchasers that describes the property, proposed terms of sale, and procedures for submitting a purchase offer. The notice in form and substance must be acceptable to HUD, and must inform potential offerors of a preference for priority purchasers.

(3) The PAE may develop a Restructuring Plan involving a sale or transfer to a non-priority purchaser only if the PAE determines that there is no interested qualified priority purchaser, or that a feasible Restructuring Plan involving a sale or transfer to a qualified priority purchaser cannot be developed.

(d) *Informing PAE; approval required.* The owner must inform the PAE of any offer to purchase the property and the owner must advise the PAE of the substance and on-going status of the owner's discussions with any prospective purchaser. The owner's acceptance of the offer must be subject to PAE approval, and HUD approval of the Restructuring Plan.

§ 401.481 Subsidy layering limitations on HUD funds.

(a) *PAE subsidy layering certification required for Restructuring Plan.* The PAE must certify to HUD that any Restructuring Plan for which it submits a proposed Restructuring Commitment meets the requirements of either paragraph (d) or (e) of this section.

(b) *Purpose of subsidy layering certification.* The purpose of the subsidy layering certification is to ensure that any HUD assistance provided to the owner of a project pursuant to a Restructuring Plan is no more than is necessary to permit the project to continue to house tenants with an income mix comparable to the income mix of the project before the Restructuring Plan is implemented, after taking into account other Government assistance described in section 102(b)(1) of the Department of Housing and Urban Development Act of 1989 (42 U.S.C. 3545(b)(1)).

(c) *Relationship to section 102(d) of HUD Reform Act.* HUD is not required to perform a separate subsidy layering analysis under section 102(d) of the Department of Housing and Urban Development Reform Act of 1989 (42 U.S.C. 3545(d)), section 911 of the Housing and Community Development Act of 1992 (42 U.S.C. 3545 note), or § 4.13 of this title for any HUD assistance that is included in the

Restructuring Plan. HUD will adopt the PAE certification under this section if a HUD certification would otherwise be required under section 102(d).

(d) *Certification under existing HUD guidelines.* If the PAE has delegated authority from HUD to make section 102(d) subsidy layering certifications in accordance with section 911 of the Housing and Community Development Act of 1992, the PAE may comply with this section by using a procedure substantially similar to the procedure described in the Administrative Guidelines published on December 15, 1994 (59 FR 64748), or any subsequent procedure adopted by HUD to implement section 911.

(e) *Other procedures.* If the PAE does not have the delegated authority described in paragraph (d) of this section, the PAE must submit to HUD for approval proposed procedures for making the subsidy layering certification under this section. Any procedures must conform to the procedures described in paragraph (d) of this section to the extent feasible and appropriate.

§ 401.483 Leasing units to certificate and voucher holders.

A Restructuring Plan must prohibit any refusal of the owner to lease a unit solely because of the status of the prospective tenant as a section 8 certificate or voucher holder.

§ 401.484 Property management standards.

(a) *General.* Each PAE is required by section 518 of MAHRA to establish management standards consistent with industry standards and HUD guidelines. The management standards must be included or referenced in the Restructuring Plan.

(b) *HUD guidelines.* At a minimum, the PAE's management standards must require the project management to:

(1) Protect the physical integrity of the property over the long term through preventative maintenance, repair or replacement;

(2) Ensure that the building and grounds are routinely cleaned;

(3) Maintain good relations with the tenants;

(4) Protect the financial integrity of the project by operating the property with competitive and reasonable costs and maintaining appropriate property and liability insurance at all times;

(5) Take all necessary measures to ensure the tenants' physical safety; and

(6) Comply with other provisions that are required by HUD, including termination of the management agent for cause.

(c) *Conflicts of interest.* The PAE management standards must also conform to any guidelines established by HUD, and industry standards, governing conflicts of interest between owners, managers and contractors.

§ 401.500 Required notices to third parties.

(a) *General.* The PAE must solicit, and document the consideration of, tenant and local community comments. As a minimum, the notices described in paragraphs (b) and (c) of this section, in form and substance acceptable to HUD, must be provided. The PAE may require the owner to give the notices if permitted by HUD.

(b) *Notice of intent to restructure and consultation meeting.* (1) This notice must include at a minimum:

(i) The project, including its name and FHA Project Number;

(ii) The responsible PAE and contact person, including the address and telephone number;

(iii) The owner's notice of intent to restructure through the Mark-to-Market Program; and

(iv) The date of expiration of the project-based assistance.

(2) This notice must state how comments may be provided to the PAE regarding any of the following: the physical condition of the property, whether the rental assistance should be tenant-based or project-based, any proposed sale or transfer of the property, and other matters regarding the property and its management. The notice must establish the date, time and place for a public meeting to be held no sooner than 20 days and no later than 60 days following the date of this notice. The public may provide written comments up to the date of the meeting.

(c) *Notice of completion of Restructuring Plan.* Within 10 days after either the execution of the Restructuring Commitment or a decision not to restructure, the PAE must provide a notice that describes the completed Restructuring Plan and Restructuring Commitment or the reasons not to restructure. Any completed Restructuring Plan and Restructuring Commitment must be made available during normal business hours to the public, subject to Federal, State and local laws restricting access to any information in any of these documents.

§ 401.501 Who is entitled to receive notices under § 401.500?

(a) *Recipients of all notices.* Each notice required under § 401.500 must be given to:

(1) The tenant for each unit in the project or a tenant organization; and

(2) The Chief Executive Officer of the unit of local government and the

Director of the Public Housing Authority with jurisdiction over the project location.

(b) *Other recipients.* The PAE may require notices to be sent to neighborhood representatives and other affected parties identified by the PAE or HUD.

Subpart D—Implementation of the Restructuring Plan after Closing

§ 401.550 Monitoring and compliance agreements.

(a) *Compliance agreements.* The PAE must ensure long-term compliance by the owner with MAHRA, this part, and the Restructuring Plan. As part of this responsibility, the PAE must require each owner with an approved Restructuring Plan to record and execute a Use Agreement that satisfies the requirements of § 401.408.

(b) *Periodic monitoring and inspection.* At least once a year for the term of the Use Agreement, a PAE must review the status of each project for which it developed an approved Restructuring Plan. Monitoring must include on-site inspections.

(c) *HUD acting instead of PAE.* HUD will perform, or contract with other parties to perform, the PAE's functions under this section if:

(1) The project is subject to a PRA with a PAE that is not qualified to be a section 8 contract administrator; or

(2) There is no PAE because the project is not currently subject to a PRA.

§ 401.552 Servicing of second mortgage.

HUD or its designee will be responsible for servicing the second mortgage, including determining the amounts receivable by the owner under § 401.461(b)(2). HUD may designate the PAE, with the PAE's consent, as servicer for the second mortgage.

§ 401.554 Contract administration.

HUD will offer to any PAE that is qualified to be the section 8 contract administrator the opportunity to serve as the section 8 contract administrator for a project restructured under the Mark-to-Market Program. Qualifications will be determined under both statutory requirements and requirements issued by the appropriate office within HUD, depending on the type of section 8 assistance that is provided.

Subpart E—Section 8 Requirements for Restructured Projects

§ 401.595 Contract and regulatory provisions.

The provisions of chapter VIII of this title will apply only to the extent, if any,

provided in the contract. Part 983 of this title will not apply.

§ 401.600 Will a section 8 contract be extended if it would expire while an owner's request for a Restructuring Plan is pending?

If a contract for an eligible project would expire before a Restructuring Plan is implemented, the contract may be extended at current rents for up to the earlier of 1 year or closing on the Restructuring Plan under § 401.407, with a provision for earlier termination if the PAE or HUD determines that an owner is not cooperative under § 401.402 or if an owner's request is rejected under § 401.403 or § 401.405. Any extension of the contract beyond 1 year for a pending Plan must be at comparable market rents or exception rents. An extension at comparable market rents or exception rents under this section will not affect a project's eligibility for the Mark-to-Market Program once it has been initially established under this part.

§ 401.601 Consideration of an owner's request to renew an expiring contract without a Restructuring Plan.

(a) *Applicability of part 402.* If HUD or the PAE determines that renewal at rents that do not exceed comparable market rents under § 402.4 of this chapter would be sufficient to maintain both adequate debt service coverage on the HUD-insured or HUD-held mortgage and necessary replacement reserves to ensure the long-term physical integrity of the project, the project-based assistance will be renewed under § 402.4 of this chapter (subject to § 402.7 of this chapter) without developing a Restructuring Plan.

(b) *When Restructuring Plan needed.* If HUD or the PAE determines that renewal at market comparable rents under § 402.4 of this chapter would not be sufficient to maintain adequate debt service coverage and reserves, HUD or the PAE may require a Restructuring Plan before the owner's request will be given further consideration. If HUD or the PAE determines that the project's continued operation without a Restructuring Plan is not feasible and the owner does not cooperate in the development of an acceptable Restructuring Plan, HUD will pursue whatever administrative actions it considers necessary.

§ 401.602 Tenant protections if an expiring contract is not renewed.

(a) *Notice of non-renewal or rent increase.* (1) The owner of an eligible project who has requested a Restructuring Plan and later fails to extend or renew an expiring contract,

except due to a rejection under § 401.101, § 401.403 or § 401.405, must provide a 12-month notice of contract non-renewal to tenants and HUD as provided in section 514(d) of MAHRA and a 90-day notice of any rent increase to tenants as provided in section 8(c)(8) of the United States Housing Act of 1937. HUD may prescribe the form of the notices. If the owner gives such 12-month notice, the owner is not required to give a separate 180-day notice of contract non-renewal under section 8(c)(9) of the United States Housing Act of 1937.

(2) The owner of an eligible project who has not requested a Restructuring Plan, or an owner who requested a Restructuring Plan but who has been rejected under § 401.101, § 401.403, or § 401.405, must provide 180-day notice of contract non-renewal to tenants and HUD under section 8(c)(9) of the United States Housing Act of 1937 and 90-day notice of any rent increase to tenants under section 8(c)(8) of that Act. If the owner gives such 180-day notice, the owner is not required to give a separate 12-month notice of non-renewal under section 514(d) of MAHRA.

(b) *If owner does not give notice.* If an owner described in paragraph (a)(1) or (a)(2) of this section does not give timely notice of non-renewal, the owner must permit the tenants in assisted units to remain in their units for the required notice period (either 12 months or 180 days, as applicable) with no increase in the tenant portion of their rent. This period will begin on the earlier of the date notice of non-renewal was given to the tenants and HUD or the date of expiration for the contract. If an owner described in paragraph (a) of this section does not give timely notice of any rent increase, the owner must permit the tenants in assisted units to remain in their units for 90 days with no increase in the tenant portion of their rent. This period will begin on the earlier of the date notice of any rent increase was given to the tenants or the date of expiration for the contract. The 90-day period will run concurrently with any applicable 12-month or 180-day period.

(c) *Availability of tenant-based assistance.* Subject to the availability of amounts provided in advance in appropriations, HUD will make tenant-based assistance available under the following circumstances:

(1) If the owner of an eligible project does not extend or renew the project-based assistance, any tenant residing in an assisted unit on the date of contract expiration will be eligible to receive assistance on the later of the date of expiration or the date the owner's

obligations under paragraph (b) of this section expire; and

(2) If a request for a Restructuring Plan is rejected under § 401.101, § 401.403, or § 401.405, any tenant who is a low-income family or who resides in a project-based assisted unit on the date of Plan rejection will be eligible to receive assistance on the later of the date the Restructuring Plan is rejected, or the date the owner's obligation under paragraph (b)(2) of this section expires.

§ 401.605 Project-based assistance provisions.

The project-based assistance rents for a restructured project must be the restructured rents determined under the Restructuring Plan in accordance with §§ 401.410 or 401.411.

§ 401.606 Tenant-based assistance provisions.

If the Restructuring Plan provides for tenant-based assistance, each assisted family residing in a project-based assisted unit when the project-based assistance terminates must be offered tenant-based assistance under part 982. The rent levels provided in 515(c)(4) of MAHRA will apply except for families already receiving tenant-based assistance when the project-based assistance terminates.

§ 401.607 Contract term.

The term of the initial and subsequent contract renewals under this part, whether for project-based or tenant-based assistance, will be determined by the appropriate HUD official.

Subpart F—Owner Dispute of Rejection and Administrative Appeal

§ 401.645 How does the owner dispute a notice of rejection?

(a) *Notice of rejection.* HUD will notify the owner of the reasons for a rejection under §§ 401.101, 401.402, 401.403, 401.405 or 401.451. An owner will have 30 days from receipt of this notice to provide written objections or to cure the underlying basis for the objections. If the owner does not submit written objections or cure the underlying basis for the objections during that period, the decision will become a final determination under section 516(c) of MAHRA and is not subject to judicial review.

(b) *Final decision after objection; right to administrative review.* If an owner submits written objections or asserts that the underlying basis for the objections is cured, after consideration of the matter HUD will send the owner a final decision affirming, modifying, or reversing the rejection and setting forth the rationale for the final decision.

§ 401.650 When may the owner make an administrative appeal of a final decision under this subpart?

The owner has a right to make an administrative appeal of the following:

(a) A final decision by HUD under § 401.645(b) (including a final decision under § 402.7 of this chapter);

(b) A decision by HUD and the PAE to offer a proposed Restructuring Commitment that the owner does not execute; and

(c) A decision by HUD to accelerate the second mortgage under § 401.461.

§ 401.651 Appeal procedures.

(a) *How to appeal.* An owner may submit a written appeal to HUD, within 10 days of receipt of written notice of the decision, contesting the decision and requesting a conference with HUD. At the conference, the owner may submit, in person, in writing, or through a representative, its reasons for appealing the decision. The HUD or PAE official who issued the decision under appeal may participate in the conference and submit in person, in writing, or through a representative, the basis for the decision.

(b) *Written decision.* Within 20 business days after the conference, or 20 business days after any agreed upon extension of time for submission of additional materials by or on behalf of the owner, HUD will advise the owner in writing of the decision to terminate, modify, or affirm the original decision.

(c) *Who is responsible for reviewing appeal?* HUD will designate an official to review any appeal, conduct the conference and issue the written decision. The official designated must be one who was neither involved in, nor reports to another involved in, making the decision being appealed.

§ 401.652 No judicial review.

The reviewing official's decision under § 401.651 is a final determination for purposes of section 516(c) of MAHRA and is not subject to judicial review.

PART 402—PROJECT-BASED SECTION 8 CONTRACT RENEWAL WITHOUT RESTRUCTURING (UNDER SECTION 524(a) OF MAHRA)

Sec.	
402.1	What is the purpose of part 402?
402.2	Definitions.
402.3	Contract provisions.
402.4	Contract renewals under section 524(a)(1) of MAHRA.
402.5	Contract renewals under section 524(a)(2) of MAHRA.
402.6	What actions must an owner take to request section 8 contract renewal under this part?

402.7 Refusal to consider an owner's request for a section 8 contract renewal because of actions or omissions of owner or affiliate.

402.8 Tenant protections if an expiring contract is not renewed.

Authority: 42 U.S.C. 1437f note and 3535(d).

§ 402.1 What is the purpose of part 402?

This part sets out the terms and conditions under which HUD will renew project-based section 8 contracts under the authority provided in section 524(a)(1) or (2) of MAHRA. Renewal will also be in accordance with § 401.601 of this chapter for projects without a HUD-approved Restructuring Plan under part 401 of this chapter. This part permits renewal notwithstanding part 24 of this title, but subject to section 516 of MAHRA (see § 402.7).

§ 402.2 Definitions.

The definitions in § 401.2 of this chapter apply to this part.

§ 402.3 Contract provisions.

The provisions of chapter VIII of this title will apply only to the extent, if any, provided in the contract. Part 983 of this title will not apply.

§ 402.4 Contract renewals under section 524(a)(1) of MAHRA.

HUD may renew any expiring section 8 project-based assistance contract at initial rents that do not exceed comparable market rents. If the project is eligible for a Restructuring Plan under part 401 of this chapter, the owner's request for a renewal will be processed under § 401.601 of this chapter to determine whether a Restructuring Plan is needed. After comparable market rents have been initially established, any future rent adjustments will be determined by using an OCAF as provided in § 401.412 of this chapter, except that rents may be re-determined using a budget-based rent adjustment from time-to-time at the discretion of HUD. OCAF and budget-based adjustments may be positive or negative. The term of the initial and subsequent contract renewals under this section will be determined by the appropriate HUD official.

§ 402.5 Contract renewals under section 524(a)(2) of MAHRA.

(a) *Renewal for exception project at owner's request.* HUD will renew project-based assistance under this section instead of § 402.4 if requested by the owner of a project described in paragraph (b) of this section. The term of the initial and subsequent contract renewals under this section will be determined by the appropriate HUD official.

(b) *Exception projects included.* This section applies to:

(1) A project described in section 524(a)(2)(A) through (D) of MAHRA; and

(2) A project described in section 524(a)(2)(E) of MAHRA.

(c) *Initial rent levels for exception projects.* If the owner of such a project requests renewal of project-based assistance under this section, HUD will initially renew the expiring contract at the lesser of:

(1) Existing rents adjusted by an operating cost adjustment factor established by HUD (OCAF);

(2) A budget-based rent determined in accordance with § 514(g)(3)(a) through (e) of MAHRA, except that HUD rather than a PAE will determine operating expenses and HUD may adjust the debt service component to reflect competitive interest rates; or

(3) In the case of a contract under the section 8 moderate rehabilitation program (other than single room occupancy dwellings under section 441 of the Stewart B. McKinney Homeless Assistance Act), the base rent adjusted by applying an OCAF to the base rent, minus any costs associated with debt service, with the OCAF to be applied to rents for each unit size assisted under the renewal contracts.

(d) *Rent adjustments.* Rent adjustments (either positive or negative) for contracts renewed under this section will be determined using an operating cost adjustment factor as provided in § 401.412 of this chapter, except that rents may be re-determined using a budget-based rent adjustment from time-to-time at the discretion of HUD. A budget-based adjustment may include a rent comparability analysis.

§ 402.6 What actions must an owner take to request section 8 contract renewal under this part?

(a) *Timing and content of request.* For renewals of contracts with expiration dates on or after October 1, 1998, an owner must submit the following information to HUD (or to the contract administrator in the case of a contract under the moderate rehabilitation program) at least 3 months before the expiration date of any project-based section 8 contract on a project or as soon as practicable if the contract expires before January 13, 1999:

(1) A certification that neither the owner nor any affiliate is suspended or debarred;

(2) A comparable market rent analysis (unless the project is eligible under § 402.5(b)(1) or does not have a HUD-insured or HUD-held mortgage, and the

owner is not seeking renewal under § 402.4); and

(3) If an owner is seeking contract renewal under § 402.4, the prior fiscal year's audited financial statement for the project and an owner's evaluation of physical condition as provided in § 401.450 of this chapter.

(b) *Interim extension.* While a determination of owner eligibility for a request for renewal under § 401.4 or § 401.5(b)(2) of this chapter is pending, HUD may extend the contract under § 401.600 of this chapter except that the term of the extension will be determined by HUD in its sole discretion.

(c) *Exception for moderate rehabilitation contracts.* Paragraphs (a) and (b) of this section do not apply to requests for renewal of section 8 moderate rehabilitation contracts (other than for single room occupancy dwellings under section 441 of the Stewart B. McKinney Homeless Assistance Act). Separate instructions for renewal requests will be issued by the appropriate HUD official.

§ 402.7 Refusal to consider an owner's request for a section 8 contract renewal because of actions or omissions of owner or affiliate.

(a) *Determination of eligibility.* HUD may elect not to consider the request for renewal of project-based assistance if, at any time before contract renewal:

(1) The owner or an affiliate is debarred or suspended under part 24 of this title; or

(2) HUD determines that the owner or an affiliate has engaged in material adverse financial or managerial actions or omissions as described in section 516 of MAHRA, including any outstanding violations of civil rights laws in connection with any project of the owner or an affiliate.

(b) *Dispute and appeal.* An owner may dispute a rejection and seek administrative review under the procedures in subpart F of part 401 of this chapter.

(c) *Consequences of refusal to consider request.* If an owner's request for renewal of project based assistance is rejected under this section, HUD may provide tenant-based assistance under § 401.602 of this chapter.

§ 402.8 Tenant protections if an expiring contract is not renewed.

(a) *Notice of non-renewal or rent increase.* An owner who is not eligible for a Restructuring Plan under the Mark-to-Market Program in part 401 of this chapter but who fails to renew an expiring contract must provide a 180-day notice of non-renewal to tenants

and HUD as provided in section 8(c)(9) of the United States Housing Act of 1937 and a 90-day notice to tenants of any rent increase as provided in section 8(c)(8) of that Act. HUD may prescribe the form of the notices.

(b) *If an owner does not give timely notice.* If an owner does not give timely notice of non-renewal or a rent increase, the owner must permit the tenants in

assisted units to remain in their units, with no increase in the tenant portion of their rent, for a period of 180 or 90 days, whichever is the required period for the notice that was not given. Each period will begin on the earlier of the date notice of non-renewal was given to the tenants and HUD or the date notice of rent increase was given to the tenants, whichever applies, or the date of

expiration for the contract. A 90-day period under this paragraph (b) will run concurrently with any 180-day period under this paragraph (b).

Dated: August 20, 1998.

Andrew Cuomo,
Secretary.

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