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**Department of
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**24 CFR Part 891
Mixed-Finance Development for
Supportive Housing for the Elderly or
Persons With Disabilities and Other
Changes to 24 CFR Part 891; Final Rule**

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**24 CFR Part 891**

[Docket No. FR-4725-F-02]

RIN 2502-AH83

Mixed-Finance Development for Supportive Housing for the Elderly or Persons With Disabilities and Other Changes to 24 CFR Part 891**AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.**ACTION:** Final rule.

SUMMARY: This final rule implements statutory changes that enable the use of mixed-finance and for-profit participation in the Section 202 Supportive Housing program for the elderly and the Section 811 Supportive Housing program for persons with disabilities, as well as makes other changes to those programs. The rule uses the mixed-finance development model to leverage the capital and expertise of the private developer community to create attractive and affordable supportive housing developments for the elderly and for persons with disabilities. In addition, the rule provides for the leveraging of low-income housing tax credits as well as other sources of funding. The rule sets standards for the participation of limited partner investors (who may be for-profit entities) in partnership with a sole-purpose nonprofit general partner; describes eligible fees and expenses; lays out the use of capital advances in the mixed-finance context; and covers other matters relevant to mixed-finance development of these projects. This final rule follows an interim rule published on December 1, 2003, and takes into consideration public comments on the interim rule.

DATES: *Effective Date:* October 13, 2005.

FOR FURTHER INFORMATION CONTACT: Willie Spearmon, Director, Office of Housing Assistance and Grant Administration, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000; telephone (202) 708-3000 (this is not a toll-free number). Hearing- or speech-impaired individuals may access this number through TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:**I. Background**

The American Homeownership and Economic Opportunity Act of 2000, Public Law 106-569 (AHEO Act),

amended both the Section 202 Supportive Housing program (Section 202 program) for the elderly and the Section 811 Supportive Housing program (Section 811 program) for persons with disabilities. These amendments allow the participation of for-profit limited partnerships and the use of mixed-finance development methods. Section 831 of the AHEO Act further amended section 202(k)(4) of the Housing Act of 1959 (12 U.S.C. 1701q(k)(4)), to add a for-profit limited partnership to the existing statutory definition of "private nonprofit organization," by stipulating that the sole general partner of one is a nonprofit organization meeting the requirements under 12 U.S.C. 1701q(k)(4)(A)-(C). Section 841 of the AHEO Act amended section 811(k)(6) of the National Affordable Housing Act (42 U.S.C. 8013(k)(6)) to add a for-profit limited partnership to the definition of "nonprofit organization," by stipulating that the sole general partner of one is a nonprofit organization meeting the requirements of 42 U.S.C. 8013(k)(6)(A)-(D). The statutory and/or regulatory requirements for the nonprofit organization include a nonprofit organizational structure, a governing board that includes the representation of the views of the community and is responsible for operating the development, and approval as to financial responsibility by HUD (see 12 U.S.C. 1701q(k)(4) and 42 U.S.C. 8013(k)(6), as amended). Sections 832 and 842 of the AHEO Act (12 U.S.C. 1701q(h)(6) and 42 U.S.C. 8011(h)(5), respectively) broadened the funding sources that may be used for amenities for, and the design and construction suitable for supportive housing for the elderly or persons with disabilities. Excess amenities may not be funded with the capital advance under either program, and, if other funds are used, the cost of such amenities is not taken into account in determining the amount of Federal assistance or the rent contribution of tenants.

These sections also added language stating that "[N]otwithstanding any other provision of law, assistance amounts provided under this section may be treated as amounts not derived from a Federal grant." (12 U.S.C. 1701q(h)(6) and 42 U.S.C. 8013(h)(5)). "Assistance amounts provided under this section" include capital advances. HUD does not consider capital advance funds to be grant funds. Significantly, 24 CFR part 84 of HUD's regulations codifies HUD's uniform rules for grants to institutions of higher education,

hospitals, and other nonprofit organizations. Section 84.2 of these regulations, in accordance with Office of Management and Budget's (OMB's) governmentwide circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations" on which 24 CFR part 84 is based (59 FR 47010, 47012), defines "award" as "financial assistance that provides support or stimulation to accomplish a public purpose. Awards include grants and other agreements in the form of money or property in lieu of money, by HUD to an eligible recipient * * * the term does not include * * * capital advances under the Sections 202 and 811 programs." Additionally, "recipient" is defined as "an organization receiving financial assistance directly from HUD to carry out a project or program," also in accordance with OMB's circular (see 59 FR 47013). However, consistent with HUD's treatment of capital advances, the term "recipient" in 24 CFR 84.2 is specifically defined to exclude project owners that receive capital advances under the Section 202 and 811 programs. Therefore, in its part 84 rule governing grants, HUD has distinguished capital advances from the grants covered by that part, and has treated capital advances in the same manner as mortgages insured or held by HUD. The added statutory language supports HUD's treatment of capital advances.

Sections 834 and 844 of the AHEO Act, 114 Stat. 3021-22 and 3023 amended, respectively, 12 U.S.C. 1701q(j) and 42 U.S.C. 8013(j), by adding a new paragraph to each statute relating to the use of project reserve accounts under the existing supportive housing for the elderly and persons with disabilities programs. Under these new sections, project reserves may be used to reduce the number of units by combining and retrofitting units that are obsolete or unmarketable, subject to HUD approval.

Sections 835 and 845 of the AHEO Act amended section 202(h)(1) of the Housing Act of 1959 (12 U.S.C. 1701q(h)(1)), and section 811(h)(1) of the National Affordable Housing Act (42 U.S.C. 8031(h)(1)), respectively, by clarifying that commercial facilities for the benefit of residents of the project and the community in which the project is located, may be located and operated in a supportive housing project for the elderly or persons with disabilities. Such commercial facilities cannot be subsidized with Section 202 or Section 811 funds.

Section 833 of the AHEO Act amended sections 202(b) and 202(h)(2) of the Housing Act of 1959 (12 U.S.C. 1701q(b) and 1701q(h)(2)), by removing the limitation in the Section 202 program that existing housing be acquired only from the Resolution Trust Corporation (RTC). Section 202 owners may now acquire property from other sources without the need for rehabilitation for use in supportive housing. In the case of Section 811, the statute does not limit acquisition to RTC properties (see 42 U.S.C. 8013(b)(2)).

II. Changes Made at the Final Rule Stage

In response to public comments, HUD has made some substantive changes to the December 1, 2003, interim rule (68 FR 67316) in this final rule.

A number of commenters opined that the interim rule was overly specific in its provisions in § 891.808 regarding the loan of the capital advance from the nonprofit organization to the partnership that functions as the mixed-finance owner, and that these requirements could interfere with the ability of mixed-finance developments to qualify for favorable treatment for Low Income Housing Tax Credit (LIHTC) purposes. In response, HUD has revised this section to merely provide that the sponsor may transfer the fund reservation directly to the mixed-finance owner. The parties are free, subject to compliance with legal requirements and HUD review, to structure this transaction in the way most appropriate for the development. In accordance with this less specific, more flexible approach, this final rule also removes § 891.828 of the interim rule, entitled "loan of capital advance funds to mixed-finance owner." In addition, in accordance with the goal of offering participants increased flexibility, the definition of "mixed-finance owner" in § 891.805 is revised to state that the sponsor may also, as long as it meets the statutory and regulatory criteria, be the general partner of the owner, and § 891.808 is revised to take this possibility into account.

A number of commenters stated that the cap on the amount of the developer's fee in the interim rule (a maximum of nine percent of the total project replacement cost, with no more than eight percent of the capital advance payable toward the fee) was too strict, and that the interim rule was overly specific as to the costs that could be paid from the developer's fee. In response, HUD is revising § 891.815 in this final rule to allow for developer's fees up to the percentage of total project

replacement costs allowed by the tax credit allocating agency in the state where the development is sited, up to a ceiling of 15 percent. The final rule removes the list of approved uses of the fee. The fee may be paid upfront or on a deferred basis, and may not be paid from capital advances or project rental assistance under the Section 202 or Section 811 program or tenant rents.

A major change from the interim rule is that detailed firm commitment application, mixed-finance proposal, and evidentiary material submission requirements are being removed from the rule in response to comments that these sections were overly detailed and restrictive. Instead, HUD will provide separate program guidance on these requirements. Specifically, § 891.818 is simplified to a single sentence stating that the sponsor will submit the firm commitment application in a form required by HUD. Interim § 891.820 on the mixed-finance proposal is deleted from the rule in its entirety (elements of the mixed-finance proposal will be included along with the firm commitment application process in forthcoming program guidance). Interim § 891.823 on HUD review and approval of the firm commitment application is simplified to state that HUD will review and may approve or disapprove the firm commitment application and the mixed-finance proposal. The provisions of § 891.825 on submission of evidentiary materials are replaced by the more specific term "mixed-finance closing documents," and the details in the interim rule will be moved to forthcoming program guidance. The final rule will specify that the mixed-finance closing documents must be submitted before the capital advance.

In response to comments that the conflict and identity-of-interest provisions in the interim rule could cause problems for mixed-finance development, this final rule modifies those provisions. Where there is no FHA-insured or risk-sharing project, the conflict and identity-of-interest provisions in 24 CFR 891.130 will apply. However, where an FHA-insured or risk-sharing project is provided, the conflict and identity-of-interest policies that are used in the FHA program involved will instead apply, with the exception that the nonprofit general partner must continue to adhere to the provisions of § 891.130. The conflict-of-interest provision is at § 891.832 of the final rule, along with a new cross-reference that has been added in a new § 891.130(c).

The interim rule provided for a three-month operating reserve at § 891.860. In response to comments, HUD is

clarifying that this is a minimum, not a ceiling, by adding the words "at least" in this final rule.

Discussion of the public comments received on the December 1, 2003, interim rule follows.

III. Discussion of Public Comments

The comment period for the interim rule closed on January 30, 2004. Seventeen commenters submitted comments during the comment period on a wide variety of issues related to the interim rule. The commenters included a variety of entities, including public housing authorities, housing finance agencies, and professional associations. A summary of the issues raised by the commenters follows, organized by regulatory section.

Section-by-Section Summary of Public Comments

Definition of Replacement Reserve Account (24 CFR 891.105)

Comment: There is a conflict between the definition of replacement reserve account, which states that the funds in the account may be used for repairs, replacements, or capital improvements to the project, and another section, interim rule § 891.855, which limits the use of replacement reserves to Section 202 or 811 units. The commenter would prefer to be able to use the replacement reserve for the general needs of the project, not just the Section 202 or 811 units.

HUD Response: Section 891.105 of the regulations requires that a replacement reserve account be established for the Section 202 or 811 units. Repairs to the Section 202 and 811 units are to be funded from this reserve account. Repairs to non-Section 202 or 811 units would be funded with other monies according to the financing and management structure for those units. Repairs to common elements would be prorated based on the percentage of Section 202 or 811 units. For example, if a building needed roof repairs (assuming the roof is a common element), and half the units were Section 202 or 811 units, half the repair money could be taken from the Section 202 or 811 replacement reserve. The owner could then set up a separate repair or reserve for replacement account for the non-HUD units; the rule only requires a replacement reserve account for the HUD-funded units.

Definitions of Mixed-Finance Owner and Nonprofit Organization (24 CFR 891.805)

Comment: A commenter asked whether the statutory inclusion of for-

profit limited partnerships with a nonprofit general partner (see 12 U.S.C. 1701q(k)(4) and 42 U.S.C. 8013(k)(6)) allows for limited liability companies (LLCs) in which the sole managing member is an eligible nonprofit corporation. This commenter states that in the HOPE VI program, LLCs and partnerships are treated equally. This commenter states that the statutory provision would appear to allow for an interpretation that an LLC is an eligible for-profit organization in its use of the phrase "or a corporation wholly owned and controlled by" an eligible nonprofit organization as part of the definition of "private nonprofit organization." Another commenter stated that an LLC should be included as a possible mixed-finance owner, and that more than one nonprofit general partner should be allowed within the definition of private nonprofit organization. Another commenter stated that the rule should allow LLCs as ownership entities, as the statute already permits LLCs, and that depending on state law and the preference of investors, LLCs are becoming more popular as the ownership entity in LIHTC projects. Another commenter stated that LLCs are often preferable for reasons of state law.

Some commenters stated that the definition of "mixed-finance owner" should be expanded to include a for-profit limited partnership in which a for-profit affiliate of a private nonprofit organization is the sole general partner. These commenters stated that this is the preferred structure to comply with some states' corporation laws and may be necessary to comply with local law and meet Internal Revenue Service (IRS) rules for LIHTC projects.

HUD Response: The regulatory definition of "mixed-finance owner" follows the statutory requirements of the AHEO Act of 2001, including that there be a sole general partner meeting specified requirements, specifically, requirements related to being a nonprofit organization, and that the mixed-finance owner be a limited partnership. HUD believes that the statutory definition precludes the use of LLCs as the ownership entity or the general partner or the use of more than one general partner (see 12 U.S.C. 1701q(k)(3) and (4) and 42 U.S.C. 8013(k)(5) and (6)).

Comment: A commenter stated that the definition of "nonprofit organization" stated in the rule creates difficulties for regional and national nonprofit Section 202 and Section 811 developers. The definitions require that the nonprofit have a governing board selected in a manner to ensure that there is significant representation of the views

of the community in which the housing is located. The commenter stated that it is not practical to meet this test at the level of the parent organization or sponsor. HUD should clarify that the community representation requirements can be satisfied by the general partner of the project owner.

HUD Response: As the preamble of the rule states, and the definition of eligible nonprofit and nonprofit organizations reference, the statutorily required requirement of representation of the views of the community in the Section 202 program (12 U.S.C. 1701q(k)(4)(B)) can be fulfilled by the general partner. No further clarification is required. (See § 891.805 of this final rule, and §§ 891.205 and 891.305 of the 202/811 program rules.) The governing body of the general partner must be selected in such a manner as to assure that there is significant representation of the community in which the housing is located, as required by §§ 891.205 and 891.305.

This commenter also stated that in its experience, the IRS has on policy grounds refused to confer tax-exempt status under section 501(c)(3) of the Internal Revenue Code for any entity serving as the general partner in a tax credit limited partnership. As a result, it will not be possible for the general partner entity to obtain its own section 501(c)(3) tax exemption.

HUD Response: The nature of the partnership structure is determined by the governing statute. HUD suggests that partnerships work with the IRS to determine how to structure their partnerships, within the statute and regulations, to obtain the maximum tax benefits available.

Recipient of Fund Reservation (Preamble at 68 FR 67317 and 24 CFR 891.808(a))

Comment: The requirement that the nonprofit general partner be created by a sponsor that has received a Section 202 or 811 fund reservation is not based on the statute. As long as the nonprofit general partner meets the statutory criteria for a private nonprofit organization, or nonprofit organization, as applicable, that should be sufficient assurance that the mixed-finance owner is eligible.

HUD Response: In accordance with this comment, HUD is revising this final rule to include the possibility that a sponsor that meets the statutory and regulatory requirements may either form an entity to act as the general partner of the single-purpose mixed finance owner, or itself be the general partner.

Mixed-Finance Loan Terms (24 CFR 891.808)

Comment: The rule is overly specific in its direction with respect to loan terms for the capital advance, and should be more flexible. A commenter stated that the parties to the mixed-finance transaction should define the loan terms for the capital advance rather than the rule, and recommended that the rule be redrafted to permit each transaction to be structured to meet tax credit requirements as well as the requirements of that transaction, with HUD retaining the right to review, approve, or disapprove the financial structure. Another commenter stated that the requirement that the general partner be the party that loans the funds to the mixed-finance owner could adversely impact the allocation of LIHTCs to the investors. The rule should provide that the funds can be provided to the mixed-finance owner in accordance with the terms of the HUD-approved mixed-finance proposal. Another commenter stated that the rule should permit the funds to go directly to the sponsor, which would then lend them to the mixed-finance owner.

HUD Response: HUD has revised this section to provide that the sponsor may transfer the fund reservation directly to the mixed-finance owner. The parties are free, subject to compliance with legal requirements and HUD review, to structure this transaction in the way most appropriate for the development.

Comment: A number of commenters stated that the loan to the mixed-finance owner should be at the applicable federal rate (AFR), consistent with IRS tax credit law, rather than the Section 202/811 rate.

HUD Response: HUD has removed the specific interest rate provisions from this final rule. The parties are free, subject to compliance with legal requirements and HUD review, to structure this transaction in a way most appropriate for the development.

Comment: The interim rule's characterization of the loan from the general partner to the mixed-finance owner as non-repayable will jeopardize the treatment of the loan in an LIHTC transaction because it may not be considered a true debt. HUD should clarify whether the loan must be forgiven after 40 years of operation in compliance with HUD's rules, and whether it must be non-amortizing. A possible solution might be interest-only payments for 40 years with a balloon payment of principal at the end. For similar reasons, two commenters stated that any "pass through" of HUD funds runs the risk of negative consequences

in an LIHTC transaction. A commenter stated that the repayment requirement in § 891.808(a) appears to be in conflict with preamble language stating that repayment is not required so long as the project remains available in accordance with the use restrictions (68 FR 67318).

HUD Response: The interim rule stated that the loan from the general partner to the mixed-finance owner is a non-amortizing loan to be repaid within 40 years. The non-repayment provision is a statutory provision that applies to the capital advance from HUD and repayment to HUD, and applies only so long as the use restrictions remain in effect for the entire period required.

Comment: A commenter stated that the sentence reading “however, the number of section 202 or 811 units in the development funded with the capital advance must be not less than the number of units that could have been developed with the capital advance without the use of mixed funding sources.” The commenter stated that it is unlikely that capital advance funds will be “diluted” when combined with other financing.

HUD Response: This language ensures that the capital advance is used for the number of units upon which the award was based. While, in most cases, HUD funds are used appropriately, HUD believes that this regulatory control is necessary to ensure the appropriate use of limited federal funds in all cases.

Project Rental Assistance (891.810)

Comment: Four commenters stated that project rental assistance should be characterized as rental assistance payments rather than as a federal grant. One commenter stated that few or no financings will be feasible unless and until the IRS makes a specific ruling that project rental assistance payments related to the Section 202 program are not federal grants with respect to a building or its operation, and asked that the IRS expedite such a ruling. One commenter stated that HUD should work with the IRS to clarify that project rental assistance will not be treated as federal grants to mixed-finance Section 202 projects for tax credit purposes. This commenter stated that in the absence of such a clarification, rental assistance payments may cause a dollar-for-dollar reduction in the projects eligible basis for LIHTC purposes, with a resulting reduction in the amount of available tax credits. Also, without this clarification, project rental assistance payments may cause the rent due on the unit to exceed the IRS limitation on gross rent so that the unit will fail to qualify as a rent-restricted unit. This commenter also stated that such a ruling

regarding project rental assistance is “critical to prevent reductions in LIHTC eligible basis with respect to such assistance.”

HUD Response: HUD believes that project rental assistance should not be treated as a Federal grant. Whether or not project rental assistance is to be treated as a Federal grant for LIHTC purposes is a determination that the IRS must make. HUD is in the process of discussing this matter with the IRS.

Developer's Fee (24 CFR 891.815)

Comment: Some commenters objected to the limitation on the developer's fee of nine percent of the total project replacement cost. A number of commenters suggested that the rule adopt HUD's public housing mixed-finance cost control and safe harbor standards, which the commenter states provide for a safe harbor developer's fee of nine percent of the project costs subject to a maximum developer's fee up to 12 percent of the project costs. A commenter also stated: “We think that HUD should establish a maximum developer fee that can be paid from the Section 202/811 capital advance to be used for developer overhead and profit, but also provide for some flexibility and deference to state housing finance agencies in LIHTC transactions with respect to the amount of the developer fee and the uses to which such fees can be put when paid from other sources such as LIHTC equity.”

Four commenters objected to limiting profit and overhead to six percent of construction cost. Two commenters stated that HUD could limit the amount of the fee paid from HUD funds, but should not limit the portion of the fee paid from other sources. Three commenters stated that because a mixed-finance developer will have to invest more equity and other guarantees to make projects feasible, “this arbitrary limitation on the amount of developer fees that are ordinarily available from other financing programs * * * should be removed from the rule.”

Three commenters agreed, suggesting that the developer's fee be in any amount allowed by the state tax credit allocating agency (which can be up to approximately 15 percent of the project cost), provided that no more than eight percent of the capital advance funds be used toward the fee. A commenter stated that the fee should be able to exceed 12 percent with the approval of the state housing finance agency, provided that the increased fee is justified by increased developer's risk. These commenters also stated that there should be no limitations on the use of cash flow from the non-Section 202 or

811 units so that it can be used to pay the deferred portion of the developer's fee. Some commenters stated that any portion of the developer's fee not required to cover the eligible uses of the fee should be made available to the nonprofit developer once the project has been completed, reasoning that the developer should not be penalized for any cost savings it achieves and that reserve accounts can still be adequately funded. Another commenter stated that, in order to maximize eligible basis and resulting LIHTC equity, there should be a developer's fee higher than the interim rule allows, but within the higher limit of the LIHTC program.

HUD Response: After consideration of these comments, HUD is amending the final rule to lift the cap on developer's fees in Section 202 and 811 mixed-finance projects to the amount allowed by the state tax credit allocating agency of the state in which the project is sited, up to a ceiling of 15 percent of the total project replacement cost, payable from project sources other than capital advances, project rental assistance, or tenant rents.

Comment: A commenter stated that the rule should explicitly allow the project sponsor to receive the developer's fee.

HUD Response: The developer's fee would usually be paid to the project owner, and HUD plans to follow this practice in the mixed-finance program.

Eligible Uses of Developer's Fee (24 CFR 891.815(c))

Comment: A commenter stated that the limitation on eligible uses of the developer's fee may not work well in situations where there are LIHTCs and other sources of funding. Another commenter stated that the eligible uses of the developer's fee differ from the definition of developer's fee in the LIHTC program, and stated that the rule “should acknowledge the validity of a fee for development efforts and also allow flexibility in use of other funding sources for these items.” Another commenter stated that “we are unclear as to why the description of eligible uses are considered to be part of the developer's fee.” This commenter stated that most of these uses would be funded with the capital advance as part of the development budget. This is problematic for two reasons. First, the ability of the sponsor to recoup its overhead and costs is essential to its financial viability. Second, a developer's fee is generally includable in the eligible basis of the project for LIHTC purposes, generating additional tax credit equity. To the extent that the fee be used for expenses already

included in the budget, and further requiring that any portion of the fee not so spent be placed in the replacement reserve account, the interim rule decreases the eligible tax basis. Two commenters stated that the local tax credit agency's rules should apply to the uses of the fee. One commenter stated that the prescribed uses of the developer's fee are "not realistic for mixed finance transactions." Another commenter stated that more flexibility is needed on the allowed uses of the developer's fee. Another commenter stated that the following items under § 891.815(c)(1) of the interim rule are common development costs that should be paid out of the capital advance rather than the developer's fee:

§ 891.815(c)(1)(B), (F), (H), (I), (J), (K), (L), (M), and (N).

A commenter questioned the prohibition on using the developer's fee to pay attorney's and architect's fees "above those contractually agreed to," and stated that limits on these fees from the Section 202 program are quite restrictive and should be reviewed and potentially increased to reflect the greater complexity involved in a mixed-finance transaction, which may involve re-capitalization and reconfiguration of residential and commercial spaces.

HUD Response: In accordance with the comments and to increase program flexibility, HUD is removing the specific list of eligible uses from this final rule.

General Comments on the Firm Commitment Application (24 CFR 891.818)

Comment: Commenters stated that the regulation is not the best place for a long list of submission requirements and suggested that these requirements be placed in a handbook or other program guidance. Two commenters stated generally that HUD should develop streamlined submission requirements for mixed-finance transactions.

HUD Response: In accordance with the comment, HUD is removing the detailed submission requirements and will provide separate program guidance on the particulars of these requirements. Although the language of § 891.818(a)(8) is being removed from the rule, owners are still obligated to comply with the design and construction requirements of the Fair Housing Act, and the accessibility requirements of section 504 of the Rehabilitation Act of 1973. The architecture and engineering review includes an analysis of the project design to determine if it meets the design and construction standards of the Fair Housing Act and the accessibility requirements of section 504, as well as

relevant design standards stated in 24 CFR 891.120, 891.210, and 891.310.

Specific Comments on the Firm Commitment Application (§ 891.818)

Comment: A commenter stated that § 891.818(a)(2), requiring submission of the organizational documents of the nonprofit organization and the mixed-finance owner, should be part of the evidentiary submission, since the investor limited partner, which is usually highly involved in the organizational documents of the mixed-finance owner, will probably not be selected until after there is a firm commitment. Two other commenters similarly stated that the details of the partnership might not be finished before there is a firm commitment. Another commenter stated that the rule should make clear that it is the initial partnership agreement that is required, not the agreement that is subject to negotiation with the investor. Alternatively, these documents could be submitted with the mixed-finance closing documents.

One commenter stated, as to § 891.818(a)(4), requiring a balance sheet showing that the mixed finance owner is adequately capitalized, that HUD should provide some guidance on how it will determine that the owner is adequately capitalized. Another commenter stated that HUD should accept a demand note as a means of establishing adequate capitalization. A commenter stated that, since most tax credit investors will not disburse tax credit equity until HUD has approved a drawdown of capital advance funds, the paragraph should be modified, perhaps to require a pro forma balance sheet as of the day of closing. One commenter stated that the capitalization requirement of § 891.818(a)(4) should be deleted because prior to outside investment, it is unlikely that the mixed-finance owner will be capitalized to any significant extent.

A commenter stated that § 891.818(a)(8) should state the form that the evidence of compliance with fair housing and accessibility standards should take.

A commenter stated that the requirement for obtaining zoning approvals at the time of the firm commitment application (§ 891.818(a)(7)) may not be feasible in all cases.

A commenter stated that a life cycle cost analysis (§ 891.818(a)(15)) is no longer required for HOPE VI projects, and stated that HUD should reconsider its utility for Section 202/811 projects.

A commenter stated that because of the requirement to have a final

contractor's cost breakdown and analysis (§ 891.818(a)(18)), and the fact that it is impossible to secure a contractor's bid for an unlimited period of time, there should be a time limit on HUD's review of the firm commitment application, from submission to initial closing, such as 60 days.

HUD Response: Pursuant to comments, HUD is removing from the final rule the various elements that commenters cited. HUD will be issuing program guidance that will deal with these issues, and will consider these comments in issuing this guidance. Regarding the issue of a time limit on HUD's review of the firm commitment application, HUD will endeavor to process these applications in a timely manner but, because of the likely complexity and uniqueness of mixed-finance projects, HUD declines to adopt a time limit on its review.

Mixed-Finance Proposal (§ 891.820)

Comment: A commenter stated generally that the requirement of a full mixed-finance proposal is not necessary, and the firm commitment application should serve in lieu of a mixed-finance proposal. More thorough review of documents should be handled at the evidentiary stage.

A commenter stated that experience in the public housing mixed-finance program shows that submission of all financing documents at the proposal stage (§ 891.820(b)) is not really practical. HUD should be provided with enough information about the financing to determine that the proposal is practical; however, the actual documentation of the financing should be part of the evidentiary package submission and not part of the proposal. Another commenter stated that such financing documents are duplicative of evidentiary requirements and also may not be available at the time of submission of the proposal.

A commenter stated that the certifications and assurances of legal authority to enter into the mixed-finance arrangement required by § 891.820(n) are not necessary with respect to the mixed-finance owner. The commenter stated that "it is unlikely that at the proposal stage, the mixed-finance owner will be formed and there is no need for a certification that the mixed-finance owner has authority under state and local law to develop the housing." Another commenter stated that these certifications and assurances should be part of a streamlined process.

A commenter stated that in § 891.820(b), the next-to-last sentence, which requires official confirmation of the award of tax credits from the state

allocating agency if tax credits are being used, should be modified. The commenter stated that, with respect to a nine percent tax credit project, the rule should clarify that a copy of the allocating agency's executed credit reservation contract will meet this requirement. For a four percent tax credit project using tax-exempt bonds, a credit reservation contract is not used. This commenter and one other stated that for these projects, the rule should clarify that a copy of the allocating agency's executed IRC Section 42(m) letter will meet this requirement.

A commenter stated that, because four percent credits can be derived from an issuance of tax-exempt bonds, rather than an award of tax credits, the rule be revised to add language reflecting that possibility, adding at the end of the current sentence the following:

"* * * or evidence of the issuance or intention to issue bonds on behalf of the project by the agency which will issue such bonds accompanied by a schedule illustrating the amount of credits that the project is expected to yield as a result of such bonds."

A commenter stated that the rule should clarify what constitutes a "firm and irrevocable financing commitment," as most financing commitments have some contingencies, such as final review of due diligence, appraisal, and environmental studies, and final approval by the lender's loan committee. Another commenter stated that HUD should accept funding commitments that are conditioned upon the actual certification of basis eligible costs per accepted four percent tax credit procedure. Another commenter similarly stated that conditions on financing commitments, including review of final plan specifications, review of environmental testing, and other typical due diligence items, typically are not satisfied at the stage when a firm commitment package is submitted to HUD.

HUD Response: The rule is being streamlined so that these elements are being removed in favor of forthcoming program guidance that will combine elements of the firm commitment application and the mixed-finance proposal. HUD will consider the comments received in response to the interim rule in formulating its program guidance.

HUD Review and Approval (§ 891.823)

Comment: One commenter stated as to § 891.823(b)(1) that there is no reason for HUD to make a determination that the mixed-finance owner has the legal capacity to enter into all necessary contracts and agreements. While HUD

may need to determine that the nonprofit organization has the legal capacity to participate in the transaction, there is no reason for this determination with respect to the mixed-finance owner. There are numerous checks in the closing process, including owner counsel opinions, that should provide sufficient assurance to HUD.

This commenter also stated as to § 891.823(b)(6) and (7) that these items (covenants and use restrictions, and state, local, and federal approvals and zoning changes or variances) should be submitted as part of the evidentiary review process and not the proposal process. Another commenter stated that the covenants and use restrictions are more appropriately part of the mixed-finance closing documents.

HUD Response: Rather than attempting to provide every detail about HUD review and approval, the final rule states that HUD has the authority to review and approve or disapprove firm commitment applications.

Mixed-Finance Closing Documents (§ 891.825) ("Evidentiary Materials" in the Interim Rule)

Comment: One commenter recommended streamlined evidentiary material requirements. Three commenters objected to the conflict-of-interest provisions in § 891.825(a)(1)(ii), particularly the provision that the mixed-finance owner not be under the control of the persons or firms seeking to derive profit or gain from the mixed-finance owner. One of the commenters stated that this provision is at odds with the basic purpose of the mixed-finance rule, to bring for-profit entities into the Section 202/811 program to expand the affordable housing choices of the elderly and persons with disabilities. This broad prohibition on profit or gain by participants and investors is not a realistic position. This provision relates back to when the Section 202/811 program was limited to nonprofit entities. HUD will have sufficient opportunity to review financing proposals and evidentiary documents to assure itself that the financing structure is reasonable. As to the same provision, another of these commenters stated that the rule should clarify that the limited partner will not be deemed to be controlling or directing the mixed-finance owner so long as the general partner has day-to-day decision-making authority and the limited partner's control is limited to approval rights over major decisions. Another of these commenters stated that "the investor intends to derive profit from the transaction, and whether the investor

controls or directs the partnership in the manner intended by the regulation would be impossible to determine * * *. In addition, to the extent the developer is permitted a profit, and the developer is the general partner, this requirement would also not be satisfied." This commenter states that there is no similar requirement in the HOPE VI program, and HUD's review of the proposal and mixed-finance closing documents should give sufficient assurance.

A commenter stated as to § 891.825(a)(3), requiring a deed or ground lease, that in some cases the mixed-finance owner may have already obtained a fee or leasehold interest in the property. This commenter stated that "it may be more helpful to delete any reference to a conveyance document."

Five commenters stated as to § 891.825(a)(12), requiring a legal opinion that counsel has examined the financing and that such financing has been irrevocably committed for use in carrying out the project, that the rule should not require such a legal opinion. Three of these commenters stated that attorneys would not be able to opine that funds are "irrevocably committed" to the project. Another commenter similarly stated that the legal opinion should only address customary legal issues such as the legal existence of entities, execution of documents, and the enforceability of agreements, rather than financing and irrevocability of commitments. Another commenter agreed and further stated that "* * * many law firms do not permit their attorneys to give opinions regarding the priority of recorded documents. HUD should rely on the title policy to confirm the priority of the * * * Restrictive Covenants."

Two commenters stated that the no-assignment clause in § 891.825(a)(13) could cause problems with the project, such as in the areas of enforceability of contract provisions and assurance of continued funding in the event of a default by the mixed-finance owner.

A commenter objected to § 891.825(a)(15)(ii), which requires the owner to comply with all deed restrictions, including an agreement not to dispose of the development without HUD's prior written approval during the entire period that the assisted housing use restrictions remain in effect. The commenter states that this will preclude a lender from foreclosing on the project and thus effectively eliminate the ability to obtain private financing. The commenter suggests that the rule be clarified so that this restriction does not apply to lenders whose loans are

secured by the property and the ability to transfer the property upon foreclosure, as long as the property remains subject to the use restrictions. The regulations should also permit transfer of the property to a single-asset nonprofit entity upon expiration of the initial 15-year tax credit compliance period.

Another commenter stated that the lender's deed of trust securing bond financing (for a four percent LIHTC project) must be in a superior position to all other monetary liens on the property's title. A commenter stated that the length of the use restrictions could cause serious underwriting issues for potential tax credit investors because it restricts the tenants to whom the units can be rented even if the necessary subsidies are not secured. This severely limits the investors' ability to underwrite alternate scenarios. This commenter asked that HUD consider language that at least allows an owner out of this requirement if the rental assistance is not renewed.

HUD Response: HUD plans to address the details of the mixed-finance closing documents (referred to as "evidentiary materials" in the interim rule) in separate program guidance. HUD will consider these comments in formulating that guidance.

Regarding the comments on the use restrictions, use restrictions are required by statute (12 U.S.C. 1701q(d)) and cannot be eliminated. Regarding the comment on control by the limited partners, HUD is adding modified conflict and identity-of-interest provisions in § 891.832 of the final rule. Where a mixed-finance project has an FHA-insured or risk-sharing mortgage, rather than following the conflict and identity-of-interest provisions of § 891.130, the conflict and identity-of-interest provisions of the insured or risk-sharing housing program shall apply, except that the provisions of § 891.130 shall continue to apply to the nonprofit general partner. A new § 891.130(c) has been added to contain a clarifying cross-reference to § 891.832.

Loan of Capital Advance Funds to Mixed-Finance Owner (§ 891.828)

Comment: One commenter stated that the language from § 891.808 regarding the loan or pass-through of capital advance funds from the general partner to the mixed-finance owner should be repeated in this section. In addition, the loan on a mixed-finance project using nine percent LIHTC should be "allowed as a true debt obligation."

One commenter stated that rather than the nonprofit organization, the sponsor should execute the capital

advance agreement and loan the capital advance funds to the mixed-finance owner. This commenter also stated that the Project Rental Assistance Contract (PRAC) should be executed by the mixed-finance owner, rather than the nonprofit organization, because the nonprofit organization is not technically the owner of the project.

HUD Response: HUD has determined that the fund reservation may be transferred directly from the sponsor to the mixed-finance owner, and that the detailed loan or pass-through language should no longer be part of this rule. Regarding whether the loan is a "true debt obligation," the rule leaves the parties free to structure the transaction in a manner that is beneficial to the project subject to HUD review and approval of the firm commitment application. HUD agrees that the mixed-finance owner will execute the capital advance agreement and the PRAC. However, the particulars of these elements will be outlined in separate program guidance rather than this rule in accordance with other comments, and so § 891.828 is being removed in this final rule.

Comment: A commenter commented on the requirement in this section that the mixed-finance owner provide a note evidencing a non-amortizing loan of the capital advance funds for a period of not less than 40 years. The commenter stated that the loan should not be from the nonprofit organization serving as general partner to the mixed-finance owner, or from any party that is related to the nonprofit organization under IRS rules. This commenter also suggested that there be a definition for the term "note."

HUD Response: The final rule is amended to be more flexible regarding the transfer of the capital advance funds to the mixed-finance owner and no longer contains the language to which the commenter is referring. As to the relationship between the general partner and the owner, HUD recommends that program participants work within the regulations to obtain the maximum tax benefits available, including favorable treatment for LIHTC purposes. HUD suggests that program participants consult with their attorneys and the IRS regarding how best to maximize these benefits.

The term "note" is no longer being used in this context in this final rule, so a definition is not necessary.

Drawdown (§ 891.830)

Comment: This section requires that the capital advance be drawn down in an approved ratio to other funds, in accordance with a drawdown schedule.

One commenter states that HUD should provide more flexibility in drawing down funds. For example, in some cases, it may be advantageous to draw down "soft" money first to minimize costs. Also, if faster drawdown of the capital advance allows deferral of some portion of the equity pay-in until 50 percent completion, the transaction may benefit from increased equity. HUD has shown some flexibility in early pay-in of HOPE VI funds and should do the same here. Another commenter stated that HUD should permit delaying, into the calendar year following substantial completion, the drawdown of the HUD funds required to take out that portion of tax-exempt bonds used only for construction financing as required to meet the (IRS) 50 percent test (for four percent tax credit projects).

HUD Response: The rule requires capital advance funds to be used for eligible costs actually incurred. Eligible costs are generally those referenced in the statutory sections on development cost limitations (12 U.S.C. 1701q(h) and 42 U.S.C. 8013(h)). Capital advance funds may not be used to pay for a portion of bond funding, bridge financing, or as debt service for financing. While HUD generally expects the capital advance funds to be drawn down in a one-to-one ratio for eligible costs actually incurred, HUD may permit, on a case-by-case basis, some variance from the drawdown requirement as needed for the success of the project. Further clarification of the uses of the capital advance funds will be provided in forthcoming program guidance.

Comment: A commenter stated that in certain bond-financed four percent LIHTC projects, bond proceeds are expended prior to other financing so that bond proceeds can be spent on the capitalized costs for the purpose of meeting certain legal requirements. There exists nothing in the interim rule that would preclude the use of the capital advance funds from being held and drawn down following the project's completion to pay off a portion of the bonds. This commenter suggested clarification that capital advance funds may be used to pay bridge or construction financing. Another commenter stated that the rule should allow capital advance funds to be used to collateralize tax-exempt bonds.

HUD Response: Capital advance funds may be used only for eligible expenses actually incurred. Eligible expenses are expenses of the types stated in 12 U.S.C. 1701q(h) and 42 U.S.C. 8013(h), and do not include paying off bridge or construction financing, or repaying or collateralizing bonds.

Comment: Capital advances should be usable to pay construction debt used to finance costs actually incurred, and that the rule should add a clause to that effect at the end of § 891.830(c)(4).

HUD Response: Capital advance funds must be used for eligible costs actually incurred, and may not be used to pay debt financing for costs actually incurred. The types of expenses that are eligible are the costs enumerated in 12 U.S.C. 1701q(h) and 42 U.S.C. 8013(h).

Comment: Construction lenders should have the right to exercise remedies to complete the project and to force the sponsor to use capital advances to repay loan advances made by the lender. The rule should also address the lien priority which may be required by housing finance agencies or private lenders that advance funds in excess of the capital advance. HOPE VI may provide some examples.

HUD Response: It would not be legally permissible to permit the construction lender to advance funds that would be repayable from the capital advance or PRAC funds. Capital advance funds may be used for eligible expenses actually incurred. Furthermore, the use of capital advance or PRAC funds in the event of default is subject to statutory and regulatory limitations on the use of such funds and compliance with the capital advance agreement.

Eligible Uses of Project Rental Assistance (§ 891.835)

Comment: Interim § 891.835(b)(1) would prohibit project rental assistance from being used to pay debt service. One commenter stated that it would be beneficial if Section 202 rental assistance could be used to support debt.

HUD Response: The statute requires project rental assistance to be used to pay the costs of units occupied by eligible families that are not met from project income (12 U.S.C. 1701q(c)(2)). The limitations on project rental assistance in the rule are consistent with the statutory requirements.

Replacement Reserves (§§ 891.855, 891.405(d))

Comment: One commenter stated that uses of the replacement reserves cannot be limited to the Section 202/811 units. There are many costs that will need to be incurred on a pro rata basis, such as roof repairs. Another commenter stated that income from the HUD units should be used to meet the replacement reserve requirement.

HUD Response: In the case of repairs to common elements, the Section 202/811 replacement reserve can be used on

a pro rata basis based on the percentage of Section 202 or 811 units in the building whose common elements are being repaired.

Comment: HUD should provide additional guidance to field offices so that the authority to retrofit obsolete units can be implemented.

HUD Response: HUD does not believe additional formal guidance for field offices on using replacement reserves for retrofitting is needed at this time. HUD will address issues that arise in this regard on a case-by-case basis. If it should appear in the future that such guidance may be advisable, HUD may consider it at that time.

Comment: Interim § 891.405(d) should recognize that in some cases retrofitting an obsolete unit may not be possible, and that conversion of an unmarketable unit to some other form of amenity would also be permitted.

HUD Response: The idea behind this requirement is to use retrofitting to increase the supply of marketable units, such as by combining two unmarketable efficiencies into one, one-bedroom unit. Removing units entirely from the housing stock for other uses is not contemplated by this provision.

Operating Reserve (§ 891.860)

Comment: The proposed three-month operating reserve should be a minimum and that if the parties agree to establish a larger reserve out of tax credit equity or other sources they are free to do so. The mixed-finance owner should have the discretion to increase the operating reserve beyond three months.

HUD Response: If there are funds available, the operating reserve may be larger than a three-month reserve. This provision has been revised in this final rule to provide in § 891.860 that the operating reserve must be sufficient for "at least" three months.

Comment: Income from the HUD units should be used to meet the operating reserve requirement.

HUD Response: 24 CFR 891.860(b) states that project income can be used to fund the operating reserve account. However, as § 891.860(c) states, income derived from Section 202 or 811 units may be used only for operating expenses of those units.

Comment: One commenter requested clarification as to why the rule limits funding the reserve to profits and tax credit equity. Although these are the most common sources of reserve funding, sponsors might find other sources of funding. Another commenter questioned the requirement of an operating reserve, stating that one is not required in the regular Section 202/811 program; however, given the fact that

this rule requires an operating reserve, the commenter stated that it wants clarification that project income usable for this purpose includes income from the Section 202 or 811 units. This commenter stated that such operating reserves should be available for the entire development, and § 891.835(b)(3), disallowing the use of project rental assistance for the creation of reserves for non-Section 202 or 811 units, should be removed.

HUD Response: The rule permits the operating reserve to be funded with project income and tax credit equity, but imposes no limitation on other funds that may be used for the reserve. As to the issue of the usage of operating reserve, the Section 202 or 811 reserve account may be used only for the 202 or 811 units. Project rental assistance is limited to payment for the costs of the Section 202 or 811 units.

Maintenance as Supportive Housing Units for Elderly Persons or Persons With Disabilities (§ 891.863)

Comment: One commenter stated that the requirement that the use restrictions for Section 202 and 811 projects be superior to any foreclosure will reduce the likelihood that conventional lenders will provide financing. This commenter states that, upon foreclosure, the use restriction should allow for higher income levels, such as moderate income. Another commenter stated that the nonprofit organization or other qualified nonprofit approved by HUD and others providing funding to the project should have the right of first refusal and option to purchase the property from the partnership, so long as the use restrictions remain in effect as required by this section.

HUD Response: The use limitations are statutory, and hence required (12 U.S.C. 1701q(d)(1) and 42 U.S.C. 8013(e)(1)). According to statute, if the use restrictions do not remain in place for the full statutory period of 40 years, the capital advance becomes repayable to HUD. The final rule is revised to take into account the possibility of ownership changes or transfers during the 40-year use period.

General and Miscellaneous Comments

Comment: HUD should remain faithful to the congressional intent of the AHEO Act, which is to provide additional development options to increase the supply of affordable housing for elderly and disabled families.

HUD Response: HUD believes that this final rule fulfills these objectives.

Comment: The rule should have sufficient flexibility to accommodate the

real-world complexities of layered-subsidy development deals. Because these transactions are likely to be extremely complicated, this commenter stated that HUD should appoint a contact person at Headquarters who would be responsible for providing field staff and the general public "clear, consistent, and timely guidance" on HUD's mixed-finance development requirements.

HUD Response: As explained elsewhere in this preamble, HUD has provided additional flexibility in this final rule. As to the issue of an agency contact, participants in the mixed-finance program, as in the regular Section 202 or Section 811 program, should work with their local HUD office staff. Local HUD offices can forward inquiries to Headquarters if necessary.

Comment: HUD should eliminate the "stand-alone bias" in the Section 202 program. The commenter stated that under the interim rule, HUD funds can be combined with other funds only if the other funds are non-amortizing, and there is a condominium structure that provides a "firewall" for HUD funds. The commentator said this creates serious problems with developing mixed-use projects. Eliminating this bias would affect two kinds of projects: ones where the capital advance has not kept pace with the cost of development; and ones which are too small to be viable, or which propose to meet a greater need than the HUD subsidy allows. This commenter suggests that the rule allow HUD financing to be blended with other financing, and that HUD permit its capital advance funding to be subordinate to a bank or housing finance agency mortgage on the property. Similarly, three commenters stated that the rule assumes "that the funding sources for mixed-finance projects will be neatly divided between dwelling units funded by the Section 202 Capital Advance and those dwelling units funded through other sources.* * *" However, according to the commenters, it is likely that the underwriting structure of certain projects will require the combining of several sources. This should be acceptable to HUD as long as the units in such a project are subject to the regulatory agreement for the entire 40-year period, and therefore regulations should make this explicit.

HUD Response: HUD financing comes with statutory restrictions and hence regulatory ones designed to ensure the appropriate use of the funds according to statute and conflict of interest. The mixed-finance program allows the use of mixed funding sources; however, the

federal funds still have to be treated in accordance with Federal requirements.

Comment: One commenter states that there have been historic problems with combining other funding sources with Section 202 projects because of the long history of the Section 202 program being a stand-alone program and the small staff at HUD field offices. This commenter states that the underwriting for this program should be delegated to the state agency that is underwriting the project for the tax credit program. This is similar to the HOME program. If this is done, there should be agreement that the LIHTC regulations should prevail in the case of conflict with the Section 202 regulations.

HUD Response: HUD intends to retain the underwriting responsibilities for the program at this time. HUD will be competitively selecting proposals for this program in accordance with the Department of Housing and Urban Development Reform Act of 1989 (Pub.L. 101-235, approved December 15, 1989) (HUD Reform Act). Each year a notice of funding availability (NOFA) is published in the **Federal Register** specifying in detail all of the requirements that must be met by applicants for funding, in order to be selected for funding. These requirements include statutory and regulatory and program requirements that must be satisfied by all applicants, if selected for funding. Failure on HUD's part to require compliance with all of these requirements would be a violation of the HUD Reform Act. Since requiring such compliance is HUD's responsibility and within HUD's expertise, HUD will retain the underwriting functions.

In any case of conflict between LIHTC regulations and Section 202 regulations, the Section 202 regulations would prevail. Applicants desiring to develop Section 202 or 811 mixed finance projects must describe in their applications in general terms that they plan to develop a mixed finance project. It is the sole responsibility of the applicants to develop mixed finance projects that will be consistent both with their obligations under the 202 or 811 NOFAs and the LIHTC regulations and requirements. Prior to developing their mixed finance proposals, applicants will have been competitively selected for 202 or 811 funding and will have accepted a letter obligating these funds and specifying conditions that must be satisfied. Under a prior year's NOFAs, applicants unable to develop a mixed finance project were able to proceed with the 202 or 811 project, since no rating points were affected. In the FY 2004 and 2005 NOFAs, since

points are awarded for the number of additional units to be provided through mixed finance, failure to proceed with the mixed finance proposal will result in loss of the 202 or 811 funds reservation. Any deviation from the Section 202 or 811 NOFA requirements in order to meet the LIHTC requirements would result in a violation of the HUD Reform Act.

Comment: One commenter states that designation of the capital advance as a Federal grant is "likely," which will cause it to be excluded from the eligible basis for LIHTC purposes. This commenter states that the capital advance should be specifically excluded from the definition of "Federal grant" under Section 42. Another commenter states that the ability of a capital grant to be forgiven by compliance with the use restrictions may result in it being treated as a grant for tax credit purposes.

HUD Response: Both Sections 202 and 811, as amended by the AHEO Act, contain a clause stating that amounts provided under these sections may be treated as amounts not derived from a Federal grant.

Comment: The Section 202 program currently requires the sponsor to receive a property tax exemption from the local jurisdiction where the property is located. For mixed finance projects, the owners are for-profit entities in a legal sense, and therefore, in most cases, will not qualify for an exemption. In addition, contributions to local taxes may help combat negative perceptions of affordable housing. HUD should eliminate this requirement.

HUD Response: If available, the sponsor should seek such an exemption; however, HUD will not refuse to enter into a firm commitment if the exemption cannot be obtained.

Comment: Two-bedroom units should be allowed in elderly projects to expand the marketability and community feeling of elderly projects.

HUD Response: Two-bedroom units will be permitted in mixed finance projects that propose additional units as long as the number of two-bedroom units comprise no more than 10 percent of the total units in the project and are limited to the additional units. Under 24 CFR 891.210, the Section 202 units for the residents are required to be no larger than one-bedroom units.

Comment: Section 202 units and tax credit units should target different income groups. This commenter states that the rule should limit Section 202 units to those with incomes under 30 percent of the area median income, and tax credit units to those earning 30 to 60 percent of the area median income. However, this commenter stated that

this distinction is not necessary for the Section 811 program because the market is different.

HUD Response: All statutorily eligible applicants are legally entitled to apply and participate equally in the program.

Comment: One commenter stated that the interim rule allows LIHTCs to be used only for additional units and not to provide gap financing. "This ruling clearly does not aid in the development of more housing for the elderly, the sole purpose of the ruling when 202 program funds are not adequate to bring a development to completion. Why would a developer choose to build more units when the fund reservation for the initial units is not adequate?" This commenter stated that due to shortfalls in the existing programs, it is necessary to use LIHTCs for gap financing to complete projects.

Another commenter read the interim rule as allowing LIHTCs to be used for gap financing and wrote in support of that approach.

HUD Response: As long as the number of assisted units is consistent with the capital advance, equity from tax credits in a mixed-finance project may be used to provide additional units, gap financing, or a mix of additional units and financing.

IV. Findings and Certifications

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (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 mandate on any state, local, or tribal government or the private sector within the meaning of UMRA.

Environmental Impact

A Finding of No Significant Impact with respect to the environment was made at the interim rule stage in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). That Finding of No Significant Impact remains applicable to this rule and is available for public inspection between the hours of 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the docket file

by calling the Regulations Division at (202) 708–3055 (this is not a toll-free number).

Impact on Small Entities

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this rule and in so doing certifies that this rule would not have a significant economic impact on a substantial number of small entities. The program will provide capital advances to private nonprofit organizations and nonprofit consumer cooperatives to expand the supply of supportive housing for the elderly and to nonprofit organizations to expand the supply of supportive housing for persons with disabilities. Private for-profit entities may also participate in the mixed-finance aspect of producing such housing. Although small and private entities may participate in the program, the rule does not impose any legal requirement or mandate upon them and, accordingly, will not have a significant impact on them.

Federalism Impact

Executive Order 13132 (entitled "Federalism") prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the relevant requirements of section 6 of the Executive Order are met. This rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt state law within the meaning of the Executive Order.

Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866 (entitled "Regulatory Planning and Review"). OMB determined that this rule is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the Regulations Division, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500. Due to security measures at the HUD Headquarters building, please schedule

an appointment to review the docket file by calling the Regulations Division at (202) 708–3055 (this is not a toll-free number).

List of Subjects in 24 CFR Part 891

Aged, Civil rights, Grant programs—housing and community development, Individuals with disabilities, Loan programs—housing and community development, Low and moderate income housing, Mental health programs, Rent subsidies, Reporting and recordkeeping requirements.

The catalogue of Federal domestic assistance numbers for the programs in this rule are: 14.157 and 14.181.

■ For the reasons discussed in this preamble, HUD amends 24 CFR part 891 as follows:

PART 891—SUPPORTIVE HOUSING FOR THE ELDERLY AND PERSONS WITH DISABILITIES

■ 1. The authority citation for part 891 continues to read as follows:

Authority: 12 U.S.C. 1701q; 42 U.S.C. 1437f, 3535(d), and 8013.

Subpart A—General Program Requirements

■ 2. Amend 24 CFR 891.105 by revising the definition of "Replacement reserve account" to read as follows:

§ 891.105 Definitions.

* * * * *

Replacement reserve account means a project account into which funds are deposited, which may be used only with the approval of the Secretary for repairs, replacement, capital improvements to the section 202 or section 811 units, and retrofitting to reduce the number of units as provided by 24 CFR 891.405(d).

* * * * *

■ 3. Amend 24 CFR 891.130 to add a new paragraph (c) to read as follows:

§ 891.130 Prohibited relationships.

* * * * *

(c) *Mixed-finance projects.* Section 891.832 of this part applies to mixed-finance projects for the elderly and for persons with disabilities.

■ 4. Amend 24 CFR 891.170 by revising paragraph (b) to read as follows:

§ 891.170 Repayment of capital advance.

* * * * *

(b) The transfer of physical and financial assets of any project under this part is prohibited, unless HUD gives prior written approval. Approval for transfer will not be granted unless HUD determines that the transfer to a private nonprofit corporation, consumer

cooperative (under the Section 202 Program), a nonprofit organization (under the Section 811 Program), or an organization meeting the definition of "mixed-finance owner" in § 891.805 of this part, is part of a transaction that will ensure the continued operation of the project for not less than 40 years (from the date of original closing) in a manner that will provide rental housing for very low-income elderly persons or persons with disabilities, as applicable, on terms at least as advantageous to existing and future tenants as the terms required by the original capital advance.

Subpart B—202 Supportive Housing for the Elderly

■ 5. Amend 24 CFR 891.205 by revising the definition of "acquisition" to read as follows:

§ 891.205 Definitions.

* * * * *

Acquisition means the purchase of (or otherwise obtaining title to) existing housing and related facilities to be used as supportive housing for the elderly.

Subpart C—Section 811 Supportive Housing for Persons with Disabilities

■ 6. Amend 24 CFR 891.305 by revising the definition of "acquisition" to read as follows:

§ 891.305 Definitions.

* * * * *

Acquisition means the purchase of (or otherwise obtaining title to) existing housing and related facilities to be used as supportive housing for persons with disabilities.

* * * * *

■ 7. Revise subpart F to read as follows:

Subpart F—For-Profit Limited Partnerships and Mixed-Finance Development for Supportive Housing for the Elderly or Persons with Disabilities

- Sec.
- 891.800 Purpose.
- 891.802 Applicability of other provisions.
- 891.805 Definitions.
- 891.808 Capital advance funds.
- 891.809 Limitations on capital advance funds.
- 891.810 Project rental assistance.
- 891.813 Eligible uses for assistance provided under this subpart.
- 891.815 Mixed-finance developer's fee.
- 891.818 Firm commitment application.
- 891.820 Civil rights requirements.
- 891.823 HUD review and approval.
- 891.825 Mixed-finance closing documents.
- 891.830 Drawdown.
- 891.832 Prohibited relationships.
- 891.833 Monitoring and review.
- 891.835 Eligible uses of project rental assistance.
- 891.840 Site and neighborhood standards.

- 891.848 Project design and cost standards.
- 891.853 Development cost limits.
- 891.855 Replacement reserves.
- 891.860 Operating reserves.
- 891.863 Maintenance as supportive housing units for elderly persons and persons with disabilities.
- 891.865 Sanctions.

Subpart F—For-Profit Limited Partnerships and Mixed-Finance Development for Supportive Housing for the Elderly or Persons with Disabilities

§ 891.800 Purpose.

The purpose of this subpart is to establish rules allowing for, and regulating the participation of, for-profit limited partnerships, of which the sole general partner is a Nonprofit Organization meeting the requirements of 12 U.S.C. 1701q(k)(4) or 42 U.S.C. 8032(k)(6), in the development of housing for the elderly and persons with disabilities using mixed-finance development methods. These rules are intended to develop more supportive housing for the elderly and persons with disabilities by allowing the use of federal assistance, private capital and expertise, and low-income housing tax credits.

§ 891.802 Applicability of other provisions.

The provisions of 24 CFR part 891, subparts A through D, apply to this subpart F unless otherwise stated.

§ 891.805 Definitions.

In addition to the definitions at § 891.105, the following definitions apply to this subpart:

Mixed-finance owner, for the purpose of the mixed-finance development of housing under this subpart, means a single-purpose, for-profit limited partnership of which a Private Nonprofit Organization with a 501(c)(3) or 501(c)(4) tax exemption (in the case of supportive housing for the elderly), or a Nonprofit Organization with a 501(c)(3) tax exemption (in the case of supportive housing for the disabled) is the sole general partner. The purpose of the mixed-finance owner must include the promotion of the welfare of the elderly or persons with disabilities, as appropriate.

Private Nonprofit Organization (in the case of supportive housing for the elderly) or *Nonprofit Organization* (in the case of supportive housing for persons with disabilities) (for the purposes of this subpart, both types of organizations are referred to as "Nonprofit Organization"), for the purpose of this subpart, means any institution or foundation (and includes a corporation wholly owned and

controlled by an organization meeting the requirements of this section):

(1) In the case of supportive housing for the elderly, that meets the requirements of the definition of "private nonprofit organization" found in § 891.205 of this title; or

(2) In the case of supportive housing for persons with disabilities, that meets the requirements of the definition of "nonprofit organization" in § 891.305 of this title; and that

(3) Is the general partner of a for-profit limited partnership, if the Nonprofit Organization meets the requirements of this definition and owns at least one-hundredth of one percent of the partnership assets. If the project will include units financed with the use of federal Low-Income Housing Tax Credits and the organization is a limited partnership, the limited partnership must meet the requirements of section 42 of the IRS code, including the requirements of section 42(h)(5). The general partner may also be the sponsor so long as it meets the requirements of this rule for sponsors and general partners.

§ 891.808 Capital advance funds.

(a) HUD is authorized to provide capital advance funds to expand the supply of supportive housing for the elderly and persons with disabilities in accordance with the rules and regulations of the Section 202 and Section 811 supportive housing programs. For mixed-finance projects, HUD provides a capital advance funds reservation to the sponsor, which transfers the fund reservation to the mixed-finance owner meeting the requirements of this subpart. The sponsor may transfer the fund reservation directly to the owner or to the general partner of the owner, or the sponsor may be the general partner of the mixed-finance owner if the sponsor meets the applicable statutory and regulatory requirements.

(b) Developments built with mixed-finance funds may combine Section 202 or Section 811 units with other units, which may or may not benefit from federal assistance. The number of Section 202 or Section 811 supportive housing units must not be less than the number specified in the agreement letter for a capital advance. In the case of a Section 811 mixed-finance project, the additional units cannot cause the project to exceed the applicable Section 811 project size limit if they will also house persons with disabilities.

§ 891.809 Limitations on capital advance funds.

Capital advances are not available in connection with:

(a) Acquisition of facilities currently owned and operated by the sponsor as housing for the elderly, except with rehabilitation as defined in 24 CFR 891.105;

(b) The financing or refinancing of federally assisted or insured projects;

(c) Facilities currently owned and operated by the sponsor as housing for persons with disabilities, except with rehabilitation as defined in 24 CFR 891.105; or

(d) Units in Section 202 direct loan projects previously refinanced under the provisions of section 811 of the American Homeownership and Economic Opportunity Act of 2000, 12 U.S.C. 1701q note.

§ 891.810 Project rental assistance.

Project Rental Assistance is defined in § 891.105. Project Rental Assistance is provided for operating costs, not covered by tenant contributions, attributable to the number of units funded by capital advances under the Section 202 and Section 811 supportive housing programs, subject to the provisions of 24 CFR 891.445. The sponsor of a mixed-finance development must obtain the necessary funds from a source other than project rental assistance funds for operating costs related to non-202 or -811 units.

§ 891.813 Eligible uses for assistance provided under this subpart.

(a) Assistance under this subpart may be used to finance the construction, reconstruction, or rehabilitation of a structure or a portion of a structure; or the acquisition of a structure to be used as supportive housing for the elderly; or the acquisition of housing to be used as supportive housing for persons with disabilities. Such assistance may also cover the cost of real property acquisition, site improvement, conversion, demolition, relocation, and other expenses that the Secretary determines are necessary to expand the supply of supportive housing for the elderly and persons with disabilities.

(b) Assistance under this subpart may not be used for excess amenities, as stated in 24 CFR 891.120(c). Such amenities may be included in a mixed-finance development only if:

(1) The amenities are not financed with funds provided under the Section 202 or Section 811 program;

(2) The amenities are not maintained and operated with Section 202 or 811 funds;

(3) The amenities are designed with appropriate safeguards for the residents' health and safety; and

(4) The assisted residents are not required to use, participate in, or pay a fee for the use or maintenance of the amenities, although they are permitted to do so voluntarily. Any fee charged for the use, maintenance, or access to amenities by residents must be reasonable and affordable for all residents of the development.

(c) Notwithstanding any other provision of this section, §§ 891.220 and 891.315 on "prohibited facilities" apply to mixed-finance projects containing units assisted under section 202 or 811.

§ 891.815 Mixed-finance developer's fee.

(a) *Mixed-finance developer's fee.* A mixed-finance developer may include, on an up-front or deferral basis, or a combination of both, a fee to cover reasonable profit and overhead costs.

(b) *Mixed-finance developer's fee cap.* No mixed-finance developer's fee may be a greater percentage of the total project replacement costs than the percentage allowed by the state housing finance agency or other tax credit allocating agency in the state in which the mixed-finance development is sited. In no event may the mixed-finance developer's fee exceed 15 percent of the total project replacement cost.

(c) *Sources of mixed-finance developer's fee.* The mixed-finance developer's fee may be paid from project income or project sources of funding other than Section 202 or 811 capital advances, project rental assistance, or tenant rents.

§ 891.818 Firm commitment application.

The sponsor will submit the firm commitment application including the mixed-finance proposal in a form described by HUD.

§ 891.820 Civil rights requirements.

The mixed-finance development must comply with the following: all fair housing and accessibility requirements, including the design and construction requirements of the Fair Housing Act; the requirements of section 504 of the Rehabilitation Act of 1973; accessibility requirements, project standards, and site and neighborhood standards under 24 CFR 891.120, 891.125, 891.210, 891.310, and 891.320, as applicable; and 24 CFR 8.4(b)(5), which prohibits the selection of a site or location which has the purpose or effect of excluding persons with disabilities from federally assisted programs or activities.

§ 891.823 HUD review and approval.

HUD will review and may approve or disapprove the firm commitment application and mixed finance proposal.

§ 891.825 Mixed-finance closing documents.

The mixed-finance owner must submit the mixed-finance closing documents in the form prescribed by HUD. The materials shall be submitted after the firm commitment has been issued and prior to capital advance closing.

§ 891.830 Drawdown.

(a) Upon its approval of the executed mixed-finance closing documents and other documents submitted and upon determining that such documents are satisfactory, and after the capital advance closing, HUD may approve the drawdown of capital advance funds in accordance with the HUD-approved drawdown schedule.

(b) The capital advance funds may be drawn down only in an approved ratio to other funds, in accordance with a drawdown schedule approved by HUD. The mixed-finance owner shall certify, in a form prescribed by HUD, prior to the initial drawdown of capital advance funds, that they will not draw down more capital advance funds than necessary to meet the pro rata share of the development costs for the 202 or 811 supportive housing units. The mixed-finance owner shall draw down capital advance funds only when payment is due and after inspection and acceptance of work covered by the drawdown.

(c) Each drawdown of funds constitutes a certification by the mixed-finance owner that:

(1) All the representations and warranties submitted in accordance with this subpart continue to be valid, true, and in full force and effect;

(2) All parties are in compliance with their obligations pursuant to this subpart, which, by their terms, are applicable at the time of the drawdown of funds;

(3) All conditions precedent to the drawdown of the funds by the mixed-finance owner have been satisfied;

(4) The capital advance funds drawn down will be used only for eligible costs actually incurred in accordance with the provisions of this subpart and the approved mixed-finance project, which include the types of costs stated in 12 U.S.C. 1701q(h), and 42 U.S.C. 8013(h), and do not include paying off bridge or construction financing, or repaying or collateralizing bonds; and

(5) The amount of the drawdown is consistent with the ratio of 202 or 811 supportive housing units to other units.

§ 891.832 Prohibited relationships.

Section 891.130 applies, except that in the mixed-finance program only, in FHA-insured or risk-sharing projects under this rule, the conflict-of-interest and identity-of-interest rules applicable to the FHA program apply. In the case of FHA insured or risk-sharing projects, the nonprofit general partner must continue to adhere to the provisions of § 891.130.

§ 891.833 Monitoring and review.

HUD shall monitor and review the development during the construction and operational phases in accordance with the requirements that HUD prescribes. In order for units assisted under the 202 and 811 programs to continue to receive project rental assistance, they must be operated in accordance with all contractual agreements among the parties and other HUD regulations and requirements. It is the responsibility of the mixed-finance owner and Nonprofit Organization to ensure compliance with the preceding sentence.

§ 891.835 Eligible uses of project rental assistance.

(a) Section 202 or 811 project rental assistance may be used to pay the necessary and reasonable operating costs, as defined in 24 CFR 891.105 and approved by HUD, not met from project income and attributed to Section 202 or 811 supportive housing units. Operating cost standards under 24 CFR 891.150 apply to developments under this part.

(b) Section 202 or 811 project rental assistance may not be used to pay for:

(1) Debt service on construction or permanent financing, or any refinancing thereof, for any units in the development, including the 202 or 811 supportive housing units;

(2) Cash flow distributions to owners;

or
(3) Creation of reserves for non-202 or -811 units.

(c) HUD-approved operating costs attributable to common areas or to the development as a whole, such as groundskeeping costs and general administrative costs, may be paid from project rental assistance on a pro-rata basis according to the percentage of 202 or 811 supportive housing units as compared to the total number of units.

§ 891.840 Site and neighborhood standards.

For section 202 or 811 mixed-finance developments, the site and neighborhood standards described at § 891.125 and § 891.320 apply to the entire mixed-finance development.

§ 891.848 Project design and cost standards.

The project design and cost standards at § 891.120 apply to mixed-finance developments under this subpart. Sections 891.220 and 891.315 on prohibited facilities shall apply to mixed-finance developments under this subpart.

§ 891.853 Development cost limits.

The Development Cost Limits for development activities, as established at § 891.140, apply to Section 202 or 811 supportive housing units in mixed-finance developments under this subpart.

§ 891.855 Replacement reserves.

(a) The mixed-finance owner shall establish and maintain a replacement reserve account for Section 202 or 811 supportive housing units. This account must meet all the requirements of 24 CFR 891.405.

(b) The mixed-finance owner may obtain a disbursement from the reserve only if the funds will be used to pay for capital replacement costs for the Section 202 or 811 supportive housing units in the mixed-finance development and in accordance with the terms of the regulatory and operating agreement. In the case of repairs to common elements, the Section 202/811 replacement reserve can be used on a pro rata basis based on the percentage of Section 202 or 811 units in the building whose common elements are being repaired. In the event of a disposition of the mixed-finance development, or the dissolution of the owner, any Section 202 or 811 funds remaining in the replacement reserve account must remain dedicated to the Section 202 or 811 supportive housing units to ensure their long-term viability, or as otherwise agreed by HUD.

(c) Subject to HUD's approval, reserves may be used to reduce the number of Section 202 or 811 dwelling units in the development for the purpose of retrofitting units that are obsolete or unmarketable.

§ 891.860 Operating reserves.

(a) The mixed-finance owner shall maintain an operating reserve account in an amount sufficient to cover the operating expenses of the development for at least a three-month period.

(b) Project income, project rental assistance, tenant rents, and tax credit equity may be used to fund the operating reserve account.

(c) Amounts derived from Section 202 or 811 (e.g., project income, project rental assistance, and tenant rents) in operating reserve accounts may only be used for the operating expenses of the 202 or 811 units.

§ 891.863 Maintenance as supportive housing units for elderly persons and persons with disabilities.

(a) The mixed-finance owner must develop and continue to operate the same number of supportive housing units for elderly persons or persons with disabilities, as stated in the use agreement or other document establishing the number of assisted units, for a 40-year period.

(b) If a mixed-finance development proposal provides that the Section 202 or 811 supportive housing units will be floating units, the mixed-finance owner must operate the HUD-approved percentage of Section 202 or 811 supportive housing units, and maintain the percentage distribution of bedroom sizes of Section 202 or 811 supportive housing units for the entire term of the very low-income use restrictions on the development. Any foreclosure, sale, or other transfer of the development must be subject to a covenant running with the land requiring the continued adherence to the very low-income use restrictions for the Section 202 or 811 supportive housing units.

(c) The owner must ensure that Section 202 or 811 supportive housing units in the development are and continue to be comparable to unassisted units in terms of location, size, appearance, and amenities. If due to a change in the partnership structure it becomes necessary to establish a new owner partnership or to transfer the supportive housing project, the new or revised owner must be a single-purpose entity and the use restrictions must remain in effect as provided above.

§ 891.865 Sanctions.

In the event that Section 202 or 811 supportive housing units are not developed and operated in accordance with all applicable federal requirements, HUD may impose sanctions on the participating parties and seek legal or equitable relief in enforcing all requirements under Section 202, the Housing Act of 1959, or Section 811 of the National Affordable Housing Act, all implementing regulations and requirements and contractual obligations under the mixed-finance documents.

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Assistant Secretary for Housing-Federal Housing Commissioner.

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