

## CHAPTER 7: RENTS, SHELTER COST, AND UTILITY ALLOWANCES

### 7.1 INTRODUCTION

The purpose of the low interest rate loans that the Agency makes is to enable borrowers to set rents at rates that are affordable to low- and moderate-income tenants, the target occupants for Agency-financed multi-family housing. Rents provide the necessary income stream to maintain and operate the housing. Thus, the Agency has a twofold interest in maintaining the rent streams in multi-family housing to protect the value of the property at affordable rates.

This chapter presents the program rules regarding rents, occupancy charges, and utility allowances for multi-family housing projects and the Agency's procedures for determining borrower compliance, including those for Farm Labor Housing projects. After reading this chapter, the Loan Servicer will understand the various types of project rents and how they are set, how rents are to be paid by tenants and collected and reported on by the borrower, and the procedure for changing rents in a project. They will also learn how security deposits are set and when they may be collected.

The Agency defines "rent" as the amount established as a charge for occupancy in a rental unit of Agency-financed multi-family housing. Rents must be established at the same rate for all similar units in the housing project: basic or note rent plus the utility allowance (when used) or the occupancy charge plus the utility allowance. If the utility costs are included in the rent, the rent will equal shelter costs.

Unless otherwise noted, for purposes of this discussion the term "rents" refers to both rents and occupancy charge, and "tenants" refers to both tenant and members of a cooperative.

### SECTION 1: RENT REQUIREMENTS

#### 7.2 RENT REQUIREMENTS BY PROJECT TYPE [7 CFR 3560.202]

##### A. Major Rent Levels

Subject to Agency approval, borrowers set project rents and utility allowances based on debt service and reasonable operating and maintenance expenses. Projects will have one or more of the following four rents:

- **Note rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment set at the interest rate shown in *Form RD 3560-52, Promissory Note*.
- **Basic rent** is the rental charge established to cover expenses in the housing project's approved budget and the required loan payment contained in *Form RD 3560-52* reduced by the interest credit agreement.

- **U.S. Department of Housing and Urban Development (HUD) contract rent** is the rental charge established for housing receiving project-based HUD Section 8 rental subsidies in accordance with 24 CFR Part 880 or Part 884, as applicable.
- **Low-income housing tax credit (LIHTC) rent** is the rental charge established in accordance with LIHTC requirements.

**B. Rent Levels by Project Type**

These rent levels will apply depending upon the project type as follows:

- Plan I projects, direct and full-profit projects with loans made prior to 1968, and unrestricted Farm Labor Housing projects all have rents that are note rate only. Tenants all pay the same rent depending upon the size of their unit.
- Plan II projects have a minimum rent that is the basic rent and a ceiling rent that is the note rate rent. Tenants without rental subsidies (see Chapter 8, Rental Subsidies, for details) pay a rent within that range, based on their incomes. Tenants with rental assistance pay the basic rent, although the rental subsidy may pay all or a portion of the rent on behalf of the tenant.
- HUD Section 8 projects with interest credit have a minimum basic rent, a maximum note rate rent, and a HUD rent.
- HUD Section 8 projects without interest credit have a note rate rent and a HUD rent.

Exhibit 7-1 summarizes the rents that appear in each project type.

<b>Exhibit 7-1</b>	
<b>Rents by Project Type</b>	
<b>Project Type</b>	<b>Rents</b>
Plan I projects	Note rent
Plan II projects	Note, basic
Section 8/515 projects without interest credit	Note rent, HUD contract rent
Section 8/515 projects with interest credit	Note rent, basic rent, HUD contract rent
Early projects (pre-1968, direct loan and full profit projects)	Note rent
Labor housing—On Farm	No rent or note rent
Labor housing—Off Farm	Note
Congregate housing/group homes	Note rent, basic rent
Cooperatives	Note rent, basic rent

### **C. Setting Rent Levels**

Rents are set by unit size and established by the borrower through a project budget at levels adequate to cover debt service, reasonable project operating expenses, and a return to owner if appropriate. Initial rents and any changes must be approved by the Field Office as part of the project budget approval process. Chapter 4 addresses procedures for determining whether project budgets are reasonable.

## **7.3 UTILITY ALLOWANCES [7 CFR 3560.202]**

When tenants pay some or all of their utility costs themselves, borrowers must establish a utility allowance to determine the amount tenants pay toward rent. The utility allowance is deducted from the total shelter cost calculated for the tenant, and the difference is paid by the tenant as rent. If the tenant is entitled to a utility reimbursement, management companies may issue a joint check payable to the tenant and utility company, if they choose to do so.

### **A. Setting Utility Allowances**

The utility allowance is based on expected costs for utilities. Once established, the borrower must review the utility allowance annually. This is done in conjunction with the annual budget process. The borrower must submit *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* to the Field Office and follow the procedures described in Section 4 of this chapter.

### **B. Approving Utility Allowances**

Field Office Staff must review the utility allowance documents submitted with the budget to make sure that the numbers being used are reasonable and comparable to other projects in the same market area. The Loan Servicer should check current rate schedules and known rate increases from such sources as suppliers of electric utility, natural gas utility, water and sewer service, fuel oil and bottle gas; public service commissions; real estate and property management firms; and state and local agencies, including public housing authorities. In addition, the Loan Servicer should check project budgets of any other Agency-funded projects in the area to see if utility allowances are similar. Chapter 4 provides further guidance on revising cost increase justifications.

### **C. Monitoring Utility Allowances**

To make sure that borrowers are correctly applying utility allowances, servicing staff must check tenant leases during supervisory visits of projects where tenants pay their own utilities. These leases should reflect the current utility allowances as shown on the current approved budget for the project.

## **7.4 DETERMINING TENANT RENT PAYMENT [7 CFR 3560.203]**

Tenants pay rents in an amount that depends on the project type, whether utilities are included in the rent, the tenant's income, and the availability of rental subsidy.

*Form RD 3560-8, Tenant Certificate* is used to determine individual rents. Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in accordance with 7 CFR 3560.152.

### **A. Net Tenant Contribution**

*Form RD 3560-8* is used to calculate a tenant's rent based on their income. The net tenant contribution to rent must not exceed the highest of:

- Thirty percent of monthly adjusted income, with an adjustment for any utility allowances, or
- Ten percent of gross monthly income, with an adjustment for any utility allowances, or
- If the household is receiving payment for public assistance from a public agency, the portion of such payment which is specifically designated by that agency to meet the household's shelter costs, or
- The basic rent, unless Rural Housing Service (RHS) rental assistance is provided to the household.

For an example of how to calculate the net tenant contribution, refer to Exhibit 7-2.

**Exhibit 7-2**

**Examples—Net Tenant Contribution**

**(Where Rental Assistance (RA) is Available)**

**Example 1:** The basic rent for a one-bedroom unit at Beautiful Acres Apartments is \$350 and the note rate rent is \$450. Tenants at Beautiful Acres pay their utilities directly, so there is a utility allowance of \$60. *Form RD 3560-8* for Joe Smith shows that he has an annual income of \$12,000. Since he is elderly, he receives a \$400 adjustment for elderly status, giving him an adjusted annual income of \$11,600. In completing *Form RD 3560-8*, the site manager calculates that 30 percent of Mr. Smith’s adjusted monthly income is \$290 and 10 percent of his gross monthly income is \$100. Since he is receiving no payment for public assistance, the site manager enters \$290 on line 30 (which is the highest of 30 percent of adjusted income, or 10 percent of monthly gross income, or the public assistance payment) of *Form RD 3560-8* as the Gross Tenant Contribution. The utility allowance must then be deducted, leaving a unit rent payment by Mr. Smith of \$230.

Basic Rent	\$350
Note Rate Rent	\$450
Utility Allowance	\$60
Mr. Smith’s Annual Income	\$12,000
Adjustment for Elderly Status	\$400
Adjusted Annual Income	\$11,600
30 Percent Adjusted Monthly Income	\$290
10 Percent Gross Annual Income	\$100
Payment for Public Assistance	\$0
Highest of Above	\$290
Deduction for Utility Allowance	\$60
Unit Rent Payment for Mr. Smith	\$230

**Example 2:** Joe Smith has decided to move to Cozy Home Apartments. The rents there include utilities. The basic rent for a one-bedroom unit for which he qualifies is \$360 and the note rate rent is \$460. His income information is the same, which means \$290 is again entered onto line 30, Gross Tenant Contribution, of *Form RD 3560-8*. Since there is no utility allowance, Mr. Smith will make a unit rent payment of \$290.

Basic Rent	\$360
Note Rate Rent	\$460
Utility Allowance	\$0
Mr. Smith’s Annual Income	\$12,000
Adjustment for Elderly Status	\$400
Adjusted Annual Income	\$11,600
30 Percent Adjusted Monthly Income	\$290
10 Percent Gross Monthly Income	\$100
Payment for Public Assistance	\$0
Highest of Above	\$290
Deduction for Utility Allowance	\$0
Unit Rent payment for Mr. Smith	\$290

## **B. Unit Rents**

### ***1. Note Rents***

In projects with note rents only, tenants will pay the note rent, regardless of income, unless they are income ineligible, in which case they will pay a surcharge.

When a Plan II project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a Special Note Rent (SNR) to attract or retain tenants whose income level would require them to pay note rent. An SNR is less than the note rent but is higher than the basic rent. The requirements for requesting and receiving an SNR are established under 7 CFR 3560.454.

### ***2. Basic Rents***

In projects with basic and note rents, tenants will pay their net tenant contribution, but no less than the basic rent and no more than the note rent.

### ***3. Rental Assistance Rents***

Tenants who are eligible to receive available rental assistance in a project pay the net tenant contribution. Rental assistance makes up the difference between the net tenant contribution and approved shelter costs (basic rent). Chapter 8 provides further details on charging and collecting rents from tenants with rental assistance.

### ***4. HUD Section 8/USDA Section 515 Rents***

In projects with HUD Section 8 housing assistance contracts, HUD sets the rents and utility allowances and tenants pay the borrower rent the total tenant payment (TTP), which is the greater of: 30 percent of monthly adjusted income or 10 percent of gross income; welfare rent or; \$25. The HUD rent should never be less than the basic rent. If it is, the borrower must make up the difference, since it cannot be collected from the tenant.

### ***5. Tenant-Based Subsidies***

Tenants with tenant-based subsidies such as HUD vouchers pay the rents established at the project. If the voucher is less than the project rent, the tenant is responsible for the difference.

## **C. Overage**

Overage is that portion of a tenant's net tenant contribution that exceeds basic rent up to note rent. Full overage is an amount equal

### **Example**

Jimmy Smits pays \$180 a month in rent, which is 30 percent of his adjusted monthly income. The basic rent is \$150. The \$30 difference between the basic rent and Mr. Smits's rent payment is called overage.

to the difference between the note rent for a unit and the basic rent.

#### **D. Unit Rents for Ineligible Tenants**

There will be times when ineligible tenants occupy multi-family housing units. Such tenants must pay rent based on the type of project they occupy.

##### ***1. Surcharge for Ineligible Tenants in Plan I Projects***

Ineligible tenants occupying a Plan I project must pay the established note rate rent plus a rent surcharge of 25 percent of the established rent. A Plan I project is defined in 7 CFR 3560.11.

##### ***2. Income-Ineligible Tenants in Plan II Projects***

Income-ineligible tenants occupying Plan II projects must pay the note rate rent. A Plan II project is defined in 7 CFR 3560.11.

#### **E. Unit Rents for Site Managers, Caretakers, and Owner-Occupied Units**

When used as a revenue producing unit at approved rental rates, the salary paid to the site manager and/or caretaker will be included in the project operation and maintenance expenses. The same amount will be included in the annual income of the site manager and/or caretaker. The site manager and/or caretaker may be an eligible or ineligible tenant and their rent contribution will be based on their total income from all sources as shown on the tenant certification form.

When the unit is used as a non-revenue producing unit, the project cost of providing the unit will be treated the same as those of other non-revenue producing portions of the project. Project rental rates will be established as if the unit did not exist as living quarters. Debt payment will be as if the units were rented at basic rent. A tenant certification form will not be prepared for this situation.

With prior approval of the State Director, an owner may occupy a unit in the project when the owner will manage the project rather than hiring a management agent or site manager. If the unit is a revenue-producing unit, rental rates will apply to the borrower as they would to any other caretaker or manager.

#### **F. Unit Rents for Low Income Housing Tax Credit Units**

##### ***1. Setting and Collecting Rents***

Unit rents in projects with LIHTCs will be set in accordance with regular Agency program rules. Two examples of setting such rents are provided in Exhibit 7-3. The Field Office must be aware that the LIHTC program prohibits owners from charging tenants more than a certain amount of rent in LIHTC units. Borrowers who do this risk recapture of their tax credits and stiff penalties. While the law does not allow the borrower to collect basic rent from the tenant if it exceeds the LIHTC limitation, overage

may be collected from the tenant in only those projects with 1991 and later tax credit allocations, if necessary, according to *Form RD 3560-8* even if that rent exceeds the LIHTC limitations.



**Exhibit 7-3****Setting Unit Rents for Section 515 Projects with LIHTCs**

**Example 1:** Assume the units receive only interest credit and no rental assistance or HUD Section 8 assistance. One-bedroom apartment: basic rent = \$275, LIHTC rent = \$250. The expense level required to meet financial requirements of the project exceeds the rent allowed to be charged by the low-income housing LIHTC program by \$25.

**Example 2:** Assume a project where LIHTC rent is equal to or greater than the basic rent, and a previously eligible tenant's household income increases beyond the LIHTC rent. In this case, the tenant may or may not have previously received rental assistance or HUD Section 8. Example: One-bedroom apartment: basic rent = \$250, LIHTC rent = \$300. Only one co-tenant works. Household pays \$200 per month and rental assistance is \$50. Household is Agency and LIHTC eligible. Second co-tenant goes to work, causing the household rent to go up to \$350. The new rent level exceeds both basic and LIHTC rents. Overage of \$100 is due. LIHTC rent limitations require that the owner charge tenants no more than \$300, which causes a shortage of \$50 per month in overage due the Agency. Therefore, the owner is accountable for this shortage if the project was allocated LIHTCs prior to 1991. For projects allocated LIHTCs after 1990, the owner is allowed to collect the overage due from the tenants because gross rent that tenants pay in the LIHTC unit does not include any rental payment to the owner of the unit to the extent such owner pays an equivalent amount to the Agency under Section 515. The tenant cannot be required to move based on LIHTC ineligibility.

**2. Agency Review and Monitoring of LIHTC Rents**

The law does not excuse the borrower from paying the basic rents required to the Agency; these rents must be deposited into the operating account in full. Borrowers must be informed by Loan Servicers that the borrowers are responsible for funding any gap between basic rents and tax credit rents collected from tenants when basic rent exceeds LIHTC rents. This fact should be noted when the Loan Servicer reviews the project operating budget.

Borrowers must not use project funds to make up any difference between rents required under Agency program rules and the maximum allowed rents under the LIHTC program, and they must collect the required rents. During the annual review process, Loan Servicers should review the previous year's budget with a focus on any cash shortfalls. If the Loan Servicer determines that a shortfall exists due to differences between tax credit limitations and basic rents, they must ensure that a provision is made in the coming year's budget and future years on line 11, "Cash-non project" of *Form RD 3560-7* for the owner to contribute necessary funds to meet the required rents.

**G. Adjustments to Unit Rents**

Borrowers must adjust net tenant contribution and unit rents, if applicable, whenever there is a change in tenant household status sufficient to generate a new certification in

accordance with 7 CFR 3560.152. Borrowers are not required to recertify a household prior to the annual recertification unless a change in household income of \$100 or more per month occurs. If a tenant requests it, the borrower must recertify the tenant for a change in household income of \$50 or more per month (see Chapter 6 for further details on interim recertifications).

A change in household status could take place in any one of the following circumstances:

- The tenant has had a change in income (increase or decrease);
- The tenant has had a change in the size of the household (increase or decrease in number of people residing in the unit); or
- The tenant has had a change in the type of household (the household may become handicapped or elderly, or a 17-year-old child may turn 18).

If *Form RD 3560-8* shows that a change in rents is in order as a result of the change in household status, the effective date of a tenant's changed rent is the first day of the month following third-party verification of the tenant's reported changes. However, the management agent must complete the verification process no later than 30 days following the tenant's notice of the change.

## **7.5 RENTS DURING EVICTION OR FAILURE TO RECERTIFY [7 CFR 3560.208]**

Tenants must continue to pay rents during termination through eviction and if they are not recertified for occupancy.

### **A. Rents for Tenants Being Evicted**

Tenants must continue to pay rents as per *Form RD 3560-8* while the eviction process is underway.

### **B. Rents for Tenants without a Current Certification**

A tenant who is not recertified is technically an ineligible tenant, and note rate rent must be collected and deposited to the general operating account for that tenant. Whether the tenant or the borrower/management agent pays the note rate depends upon who is to blame for the failure to recertify.

#### ***1. Tenant Failure to Recertify***

If a borrower can document that a tenant received a notice specifying a tenant recertification date, and the tenant fails to comply by the specified date or fails to cooperate with verification or other procedures related to the tenant's recertification so that the tenant recertification cannot be completed by the recertification date, the borrower, within 10 days of the recertification date, will give the tenant and the Agency written notification that:

- Termination proceedings are being initiated, in accordance with 7 CFR 3560.159; and
- The tenant will be charged note rent until the tenant's lease is terminated.

## **2. Borrower Failure to Recertify**

If a borrower cannot document that a tenant received a recertification notice, and a tenant is not recertified within 12 months of the most recently executed tenant certification, tenants will continue to make net tenant contributions to rent based on their most recent *Form RD 3560-8*. The borrower must remit to the Agency from non-project funds, full overage as if the tenant was paying the note rent until the tenant is re-certified.

## **7.6 IMPROPERLY ADVANCED RENTS [7 CFR 3560.209]**

Improperly advanced interest credit or rental assistance, whether it was the fault of the borrower or the tenant, will be recaptured in accordance with the requirements established by 7 CFR part 3560, subpart O.

### **A. Borrower Error**

When rents have been improperly collected from a tenant due to borrower error, such as a miscalculated *Form RD 3560-8* the borrower must make up the difference to the Agency for any additional rents that should have been collected or reimburse the tenant for any excess rents collected.

### **B. Tenant Fraud**

When the borrower has collected an incorrect rent amount from the tenant due to tenant fraud, the borrower must make every attempt to recapture the rent due from the tenant. Once the borrower has delivered documentation to the Loan Servicer of failed attempts to collect, the Loan Servicer must comply with the requirements of 7 CFR part 3560, subpart O to pursue collection.

## **7.7 MONITORING TENANT CONTRIBUTION AND UNIT RENTS**

### **A. Borrower Monthly Submissions**

The Loan Servicer monitors unit rents and tenant contributions on a monthly basis via *Forms RD 3560-29* and *RD 3560-8*.

### **B. Site Visits**

The Loan Servicer will verify information on *Forms RD 3560-29* and *RD 3560-8* during site visits through random tenant interviews. If the Loan Servicer is told by any tenant that they pay a different amount of rent than is shown on *Form RD 3560-29*, *Interest Credit and Rental Assistance Agreement*, for that tenant, the Loan Servicer must ask the borrower or management agent to explain the discrepancy.

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## **SECTION 2: SECURITY DEPOSITS**

### **7.8 SECURITY DEPOSITS [7 CFR 3560.204]**

Borrowers should collect security deposits as assurance of rental payment or charges for damages when it is reasonable and customary for the area in which the project is located. Security deposits are largely governed by state and local laws; Loan Servicers must familiarize themselves with those laws.

#### **A. Allowable Amounts**

The borrower must specify the amount of the security deposit that will be charged in a project by unit size in the management plan and in the dwelling lease. This amount may not be changed without prior consent of the Agency. The following requirements must be met:

- Borrowers may charge security deposits in an amount that is typical for the area, but the security deposit charged to a tenant may not exceed that tenant's contribution for one month's rent or the basic rent, whichever is greater;
- Households receiving a HUD rental subsidy must pay security deposits according to HUD requirements;
- Members in a cooperative must pay a membership fee equal to one month's occupancy charge; and
- Security deposits for tenants may not be increased in later years, even if the tenant has been residing in the project for a long time and the initial amount charged is not representative of current basic rents or security deposits.

#### **B. Payment Plans**

If tenants cannot pay the full amount of the security deposit initially, they may be placed on a payment plan. Should installments not be met, the total charge may become due and payable in full.

#### **C. Authorized Uses**

Funds in the security or membership fund account must only be used for authorized purposes as specified by the borrower's management plan.

Borrowers may charge tenants for damage or loss caused or allowed by the tenant equal to the cost of the damage or loss.

Borrowers must consider expenses due for addressing normal wear and tear as normal operating expenses and must not charge tenants a fee or withhold security deposits to pay for such costs.

Borrowers may withhold security deposits and may charge tenants for damage or loss costs above security deposit amounts. An itemized accounting for any charges against the security deposit must be presented to the tenant after the move-out inspection, unless the tenant has abandoned the project and their whereabouts are unknown and cannot be ascertained after reasonable inquiry. Resolution of any security deposit disputes must be handled in accordance with state and local laws.

Any amount which is kept by the borrower as a result of lease or occupancy agreement violation must be transferred to the general operating account and treated as project income.

#### **D. Accounting and Interest**

Security deposits must be held in a separate bank account in a Federally insured institution in accordance with 7 CFR 3560.302 (see Chapter 3). These funds are held in trust for the tenant until used or returned to the tenant.

Any interest earned on security deposits will accrue in accordance with state law, but in no case will it accrue to the project management or the borrower. If a state requires the borrower to pay the interest earned on security deposits and the borrower collects more interest than is required by the state, the additional interest must be deposited into the general operating account for use by the project.

Any interest on security deposits unclaimed by a tenant must accrue to the project and must be deposited by the borrower into the general operating account.

#### **E. Additional Deposits**

Borrowers may charge additional deposits for pets; however, these must not exceed basic rent for the animal owner's unit. Where a service animal is necessary for the normal function of a household member, an additional security deposit must not be charged.

Borrowers must not charge additional security deposits based on disabilities of tenants or other personal characteristics.

### **7.9 MONITORING SECURITY DEPOSITS**

Loan Servicing staff will monitor security deposits charged to and collected from tenants during supervisory visits by:

- Reviewing project annual financial statements;
- Reviewing dwelling leases and comparing the amount charged with what has been specified in the current management plan;
- Reviewing bank statements to see what the deposits of security deposits total; and

- Asking tenants to confirm what they have paid as security deposits.

Any discrepancies must be explained by the borrower or management agent. Monitoring of security deposit accounts is further addressed in Chapter 3.

## **SECTION 3: RENT COLLECTION**

### **7.10 RENT COLLECTION [7 CFR 3560.209]**

Borrowers must collect rent on a monthly basis. Rents should be due on the first day of the month. The time and place of onsite collection and/or the address for payment by mail should be well publicized and consideration should be given to an after-hours depository, if needed. Borrowers must maintain an accounting system to collect and track receipts that can be audited.

#### **A. Tracking Rents**

Any collection system employed by the borrower must include the following:

- A serially numbered receipt book or similar device to track collections;
- A ledger that shows which tenants have paid their rents and which have not; and
- If collections are held onsite, they must be secure. A safe may be used to ensure security.

The borrower must explain how the above requirements are to be met in the management plan. The Loan Servicer will verify that these requirements are being met during onsite supervisory visits by asking to see the receipt book or similar tracking device, the ledger, and the onsite collection device, if any.

#### **B. Fees for Late Payments**

Borrowers may adopt a late fee schedule for overdue rental payments. Late fee schedules must be submitted to the agency for approval as part of the housing project's management plan, be in accordance with state and local law, and consistent with the following requirements:

- (1) A grace period of 10 days from the rental payment due date must be allowed for all tenants.
- (2) The late fee must not exceed the higher of \$10 or an amount equal to 5 percent of the tenant's gross tenant contribution.
- (3) Tenants receiving housing benefits from sources other than the Agency may be subject to the late rent fee requirements of the other funding sources.

Any other type of schedule must be submitted by the borrower to the Agency for approval. All schedules must be in accordance with state and local laws and must be

justifiable. To approve the schedule, the Loan Servicer needs to make sure that the fees are not excessive, are customary for the area, and allow for a reasonable grace period.

The borrower must describe any late fee schedule in the management plan. During the onsite supervisory visit, the Loan Servicer must ask tenants about the late fees schedule to make sure it is as the borrower has described it. The Loan Servicer must also check leases to confirm that the late fee schedule is stated and matches its description in the most current management plan. Any discrepancies must be explained by the borrower.

## 7.11 BORROWER REPORTING OF RENTS

Borrowers must report to the Agency on *Form RD 3560-29, Notice of Payment Due Report* all rents, overages, and surcharges collected. This form shows the occupancy status of each unit, rents collected from each tenant, and borrower payment and agency tracking of overage. Overage is the amount by which total rental payments paid or to be paid by the tenants of a project exceed the total basic monthly charge (see paragraph 7.4). Borrowers identify any overage collected on *Form RD 3560-29*. Overage is returned by the borrower to the Agency. Overage for an account with an interest credit agreement is charged to the account as additional interest on the initial loan. Tenant contributions must be applied first to rental charges rather than to miscellaneous charges and fees, such as late fees.

### A. Agency Tracking of Overage

The Loan Servicer must process overage that is reported and returned by the borrower with *Form RD 3560-29* through the use of MFIS. Overage is coded for Agency accounting purposes depending upon the type of project it is collected from as follows:

**Overage Type 1:** Occupancy surcharge paid by ineligible tenants in Plan I projects. Occupancy surcharge is equal to twenty-five percent (25%) of note rate rent.

**Overage Type 2:** Rents paid by tenants in a Section 8/515 Project with an Interest Credit Plan Code of 7 or 8 that are greater than the basic rent, up to the note rent.

**Overage Type 3:** Rents paid by tenants in a Plan II project that are in excess of the basic rent up to the note rate rent. This includes HUD contract rents in a Section 8/515 project with an Interest Credit Plan Code of 2 that are greater than the basic rent, up to the note rate rent.

Overage collected that is in excess of the note rate rent in Section 8/515 projects with interest credit, where the HUD contract rent exceeds note rate rent, is reported on *Form RD 3560-29* as excess Section 8 funds and is deposited into the project reserve account.

For additional information on how the Agency handles overage, please refer to the Automated Multi-Family Housing Accounting System (AMAS) manual.



**B. Payment of Overage for Multi-Family Housing Projects with Interest Credit and No Rental Assistance**

When 30 percent of a tenant's adjusted income exceeds the basic rent, the difference they pay in rent between the basic rent and the note rate rent is referred to as overage. This is returned by the borrower to the Agency as extra interest payment on the loan. Exhibit 7-4 provides an example of how overage is paid.

<b>Exhibit 7-4</b>			
<b>Example—Overage Payments at Sunny Brook</b>			
Basic Rent: \$350		Note Rate Rent: \$400	Utility Allowance: \$0
Tenant	30% of Adjusted Monthly Income	Rent Payment	Overage Payment
Smith	\$200	\$250	\$0
Miller	\$350	\$350	\$0
Jones	\$375	\$375	\$25
Young	\$400	\$400	\$50
Brown	\$400	\$400	\$50

**C. Payment of Overage for Section 8/515 Projects**

It is Agency policy that any funds paid by HUD are paid on behalf of a tenant. Therefore, the Agency does not consider any HUD Section 8 payments as excess funds until any benefits provided by the interest credit agreement are recovered. Borrowers must collect overage for their tenants as follows:

***1. For Section 8/515 Projects with a One Percent or Two Percent Reduced Interest Rate***

In 100 percent Section 8/515 projects when the HUD contract rental rate is more than the one or two percent reduced interest rate and is either equal to or less than the note rate rent, overage will be paid to the Agency in an amount equal to the difference between the HUD contract rental rate and the 1 or 2 percent reduced interest rate. The overage is reported as Overage Type 2.

In 100 percent Section 8/515 projects when the HUD contract rental rate is greater than the note rate rent, the difference between the one or two percent reduced interest rate and the HUD contract rate will be paid to the Agency and reported as overage Type 2. The amount equal to the difference between the HUD contract rental rate and the Agency note rate rent will be deposited in the reserve account as excess income.

In 100 percent Section 8/515 projects when the HUD contract rental rate exceeds the note rate rent, the borrower must use *Form RD 3560-29* to document the required deposit in the reserve account.

Exhibits 7-5 and 7-6 provide examples of how overage is determined in Section 8/515 projects.

<b>Exhibit 7-5</b>		
<b>Determining Overage in Section 8/515 Projects With 1 or 2 Percent Reduced Interest Rate—Examples</b>		
<i>Example 1</i>		
<b>1 or 2 Percent Reduced Interest Rate</b>	<b>HUD Contract Rent</b>	<b>Note Rate Rent</b>
\$250	\$300	\$375
\$50 difference paid to Agency as overage type 2		\$75 interest credit
<i>Example 2</i>		
<b>1 or 2 Percent Reduced Interest Rate</b>	<b>Note Rate Rent</b>	<b>HUD Contract Rent</b>
\$250	\$375	\$400
\$125 difference paid to Agency as overage type 2		\$25 required to be placed into reserve
Note: If the HUD contract rent and the Agency 1 or 2 percent reduced interest rent are the same, then the first column would not apply.		

**2. For Section 8/515 Projects with Full Interest Credit**

In Section 8/515 projects the overage is the difference between basic rental rate and the note rate rent including the income from HUD. The overage will be reported as Type 3.

In the cases where the HUD contract rental rate exceeds the note rate rent the difference is excess income and will be deposited in the reserve fund. The borrower should use *Form RD 3560-29*, Part I, items 23 through 29, to document the required deposit in the reserve account.

<b>Exhibit 7-6</b>		
<b>Determining Overage in Section 8/515 Projects With Interest Credit—Examples</b>		
<i>Example 1</i>		
<b>Basic Rent</b>	<b>HUD Contract Rent</b>	<b>Note Rate Rent</b>
\$175	\$300	\$375
\$125 difference paid to Agency as overage type 3 by Section 8 tenants and subject to overage type 2 by non-Section 8 tenants		\$75 interest credit and subject to overage Type 1 from non-Section 8 tenants
<i>Example 2</i>		
<b>Basic Rent</b>	<b>Note Rate Rent</b>	<b>HUD Contract Rent</b>
\$175	\$375	\$400
\$200 difference paid to Agency as overage by Section 8 tenants and subject to type 2 overage by non-Section 8 tenants		\$25 required to be placed in reserve account as excess income

## **SECTION 4: RENT CHANGES**

### **7.12 OVERVIEW**

All borrowers, including those using HUD Section 8 contract assistance, must obtain prior Agency approval for a rent increase. Changes in rental rates will apply to all units in a project. Rent change requests for multi-family housing projects with no HUD subsidy are typically submitted and reviewed at the same time the borrower submits their annual budget for approval. Rent changes in Section 8/515 projects resulting from rent increases by HUD must also be reviewed and must not automatically be approved. For any project, only the amount of rent necessary to cover project expenses must be approved. This section covers rent changes in projects without HUD subsidies, then changes in projects with HUD subsidies.

### **7.13 CHANGES IN RENTS AND UTILITY ALLOWANCES [7 CFR 3560.205]**

It may be necessary as operating costs and/or revenues in a project fluctuate for the borrower to request Agency approval to effect a rent change. Exhibit 4-1 shows the timeline for borrower submission and Agency review of rent change requests. This process is also described in Chapter 4.

#### **A. Rent Change Requests under Special Circumstances**

The Loan Servicer may accept borrower requests for rent or utility allowance changes at times other than with the annual budget submission under special circumstances where a change is necessary to preserve the financial integrity of a project and the financial distress is due to circumstances beyond a borrower's control. Such circumstances might be in the event of a natural disaster or when work-out procedures are necessary.

When a Plan II housing project is experiencing severe vacancies due to market conditions, the Agency may allow the borrower to charge a special note rent (SNR), which is less than note rent but higher than basic rent, to attract or retain tenants whose income level would require them to pay special note rent. The requirements for receiving an SNR are established under 7 CFR 3560.454.

#### **B. Annual Utility Allowance Reviews**

The borrower should review utility allowances on an annual basis to determine whether any changes have to be made. The borrower should indicate no changes to utility rates in the comment section of the budget narrative.

#### **C. Tenant Notification and Comments**

At the same time the borrower submits the initial notice to the Agency that they intend to submit a rent change request, the borrower will send or deliver notices to each tenant in the project notifying them of the rent change request that will be submitted to the Agency with their annual budget. **Appendix 4** provides an example of such a notice.

The borrower must also post this notice in a common area frequented by the tenants, such as the laundry room or near the mailboxes.

The notice must notify tenants that they have 20 days to provide their comments to the Agency. If during this time the Agency receives any tenant comments, these must be immediately forwarded to the borrower, with the identity of the tenant protected. This can be done by either paraphrasing the comments for the borrower or by removing any identifying information from the correspondence received from the tenant and forwarding it on to the borrower.

After the 20-day comment period, the Agency must notify the borrower of approval or rejection within 10 days.

#### **D. Documentation**

The borrower must fully document any rent change request. Requests for a rental charge change must be based on a realistic projected budget for the interim year or the ensuing full year. The borrower must provide to the Agency the information identified in Exhibit 7-8 with the rent or utility allowance change request.

**Exhibit 7-8****Information Required to Document Rent or Utility Allowance Change Request**

1. Form RD 3560-7 must be used to reflect the project's financial needs for the year and thereby rental charge requirements. A narrative cover letter must be included explaining why the rent change is necessary. A new operating budget for the fiscal year must show:
  - Currently approved budget at old rents;
  - Proposed budget at proposed new basic rents; and
  - Proposed budget at proposed new note rate rents (if applicable).
2. Actual utility costs. Refer to Chapter 4 for a description of the information required to document utility allowance change requests.
3. Additional documentation. Additional documentation must be attached to Form RD 3560-7 in accordance with the instructions to these forms as evidence of the need for the rent or utility allowance change.
4. Other information. Any other information the borrower believes is necessary to justify the proposed shelter cost change.

The narrative attached to the budget form must clearly explain the necessity for the change request and the Loan Servicer must analyze the supporting documentation to the budget and *Form RD 3560-7* to see if it supports the request. For example, if the rent increase is due to increased taxes, then the Field Officer should look for copies of tax increase notices in the budget documentation. If the rent increase is due to an increase in general operating expenses, the Field Officer must review those expenses for reasonableness. Chapter 4 discusses reasonableness and how a budget should be reviewed for acceptability.

**E. Agency Responsibility*****1. Reviewing the Rent Change Request***

When the borrower submits a budget with a rent or utility allowance change request, the Agency must respond to the borrower within 60 days. If the Agency does not contact the borrower, the borrower may assume that any rent change request of \$25 or less has been automatically approved.

***2. Circumstances in which the Agency Will Not Approve a Rent Increase***

The Loan Servicer must not approve a rent increase under the following circumstances:

- The borrower is able but unwilling to comply with program requirements. Such a borrower has ignored repeated requests from the Loan Servicer to take servicing actions by a specified deadline.
- If the borrower is in default of the Agency loan agreement and does not have an Agency-approved work-out plan, or is not in compliance with an Agency-approved workout plan.
- There are sufficient project funds under the existing rents to meet project operating expenses, and the borrower is not able to justify the higher rents. Such a condition is established when the project budget shows that income meets expenses at current rent levels.
- The project is operated on a profit basis, and the rent change would result in rents higher than what tenants can afford. This condition is established by comparing rents with 30 percent of tenant adjusted incomes. If it is shown that tenants would be paying in excess of 30 percent of their adjusted incomes as new rents and the increase is not necessary to meet projected costs, then the increase must not be approved.

### ***3. Rejection of Rent Change Request***

If the Loan Servicer rejects the change request, the borrower must be notified and be provided with appeal rights.

### ***4. Effective Dates of Change***

The effective dates of any approved changes will coincide with the start of the project's fiscal year or the start of the season for labor housing projects. For an allowance increase request on which comments were solicited, the borrower must deliver a notice to tenants announcing the rent or utility allowance increase to be effective 30 calendar days from the date of the notification, unless the rent increase will be the same as what was stated in the initial notice to the tenants.

If the figure is revised downward, the borrower must notify the tenants of their new rents prior to the first day of the month in which the new rent amounts are due. However, the borrower does not have to give 30 days' notice of the new rents in this case.

For notices to tenants, see **Appendix 4**.

## **7.14 RENT CHANGES FOR UNITS RECEIVING HUD SECTION 8 ASSISTANCE [7 CFR 3560.207]**

The Agency has the responsibility to review and approve project budgets on an annual basis based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer will not take into account HUD's automatic annual adjustment for Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.



**A. Reviewing Budgets with HUD Subsidies**

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have a three-column budget in properties with HUD Section 8 contracts. Exhibit 7-9 depicts how many columns are required in the budget, depending upon the project type.

<b>Exhibit 7-9</b>	
<b>Reviewing Budgets with HUD Subsidies</b>	
<b>Project Type</b>	<b>Columns Needed in Budget</b>
<ul style="list-style-type: none"> <li>• 100 percent Section 8/515 with no interest credit; HUD contract rent rate is equal to basic rent</li> <li>• 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic rent and less than note rate rent</li> <li>• 100 percent Section 8/515 without interest credit; HUD contract rent is greater than note rate rent</li> <li>• Less than 100 percent Section 8/515 with interest credit; HUD contract rent is greater than basic and less than or greater than note rate rent</li> </ul>	<ul style="list-style-type: none"> <li>• One column only showing HUD contract rent</li> <li>• Three columns showing basic rent, HUD contract rent and Agency note rate rent</li> <li>• Two columns showing HUD contract rent and note rate rent; difference is excess funds and deposited into reserves</li> <li>• Three columns showing basic rent, HUD contract rent and Agency note rate rent</li> </ul>

**B. Excess Rents**

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 7-9, the borrower must deposit the difference between the Agency approved note rate rent and the higher HUD-authorized rate into the reserve account. The manager or borrower must use *Form RD 3560-29* to document the required deposit in the reserve account.

If excess HUD rents accumulate in the reserve account beyond the sum shown in the borrower’s loan agreement or resolution, the Loan Servicer may reduce or cancel the interest credit on the project. The Agency may reinstate interest credit whenever HUD rent should become lower than the Agency note rate rent.

Before depositing excess funds in the reserve account, the borrower may have to collect overage. Whether overage is collected and a project is subject to cancellation of interest credit depend upon the issuance date and execution date of the project’s interest credit agreement.

Certain early versions of the interest credit agreement do not have a legal basis to support the Agency’s policy to cancel interest credit or collect overage to offset interest credit. Each Section 8/515 project needs to be categorized according to the issuance date

and execution date of the project's interest credit agreement on *Form FHA 444-7* or its successor *Forms FmHA 444-7* and *RD 3560-9*. Exhibit 7-10 provides a description of the rules that apply to each interest agreement form.

<b>Exhibit 7-10</b>		
<b>Impact of Interest Credit Agreement on Ability to Cancel Interest Credit, Collect Overage, and Deposit Excess Funds in the Reserve Account</b>		
<b>Form</b>	<b>Executed Before October 27, 1980</b>	<b>Executed On Or After October 27, 1980</b>
FHA 444-7, dated 11/17/69 and 7/27/72	No basis to cancel or reduce interest credit, collect overage, or deposit excess funds in the reserve account unless the borrower agrees.	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 444-7, dated 10/13/77	<ul style="list-style-type: none"> <li>• If first, second, fourth or fifth block of paragraph 2 checked, no legal basis to cancel or reduce interest credit, collect overage, or deposit excess funds into reserves.</li> <li>• If the third block of paragraph 2 is checked, no legal basis to cancel or reduce interest credit, unless borrower agrees. However, there is legal basis to collect overage and deposit excess funds to reserves and/or apply it on the loan.</li> </ul>	Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account and/or apply it on the loan.
FmHA 1944-7, dated 11/29/82		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.
FmHA 1944-7, dated 4/85		Legal basis exists to cancel or reduce interest credit, collect overage, and deposit excess funds in the reserve account.

## SECTION 5: RENTS FOR LABOR HOUSING PROJECTS

### 7.15 OFF-FARM LABOR HOUSING

#### A. Rent Structure

Tenants in Off-Farm Labor Housing are required to make a monthly rent payment in the amount equal to:

- In units with rental assistance, 30 percent of their income for rent in accordance with the amount calculated annually on *Form RD 3560-8*; or
- The approved rent, when rental assistance is not available.

## **B. Establishing a Basic Rent at the Property**

For each Off-Farm Labor Housing project, the Agency will establish a basic rent in accordance with the project's annual operating budget. This basic rent will be equal to the project's operating expenses, plus the debt service payment based on the project's one percent interest rate, as approved by the Agency.

### **7.16 ON-FARM LABOR HOUSING**

Rents for On-Farm Labor Housing should be in accordance with the employment agreement between the tenant and the borrower. In general, rents should not be required for projects assisted through the On-Farm Labor Housing program. Borrowers who choose to charge rents at On-Farm Labor Housing properties must comply with the rent setting and adjustment procedures established for Section 515 projects in this chapter.

On-farm labor housing borrowers are not required to charge security deposits, but if they do so, they must follow the terms described in Section 2 of this chapter.