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24 CFR Parts 401 and 402
Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-to-Market); Final Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Parts 401 and 402

[Docket No. FR–4298–F–07]

RIN 2502–AH09

Multifamily Housing Mortgage and Housing Assistance Restructuring Program (Mark-to-Market)

AGENCY: Office of Multifamily Housing Assistance Restructuring, HUD.

ACTION: Final rule.

SUMMARY: This final rule implements the Mark-to-Market Program through which section 8 rents for multifamily projects with HUD-insured or HUD-held mortgages will be reduced. Currently, the Program is operating under the authority of an interim rule that took effect on October 11, 1998. The purpose of the Program is to preserve low-income rental housing affordability while reducing the long-term costs of Federal rental assistance, including project-based assistance, and minimizing the adverse effect on the FHA insurance funds. A separate final rule will be published for those sections of the interim rule that govern renewal of section 8 project-based assistance contracts for projects outside of the Mark-to-Market Program.

EFFECTIVE DATE: April 21, 2000.

FOR FURTHER INFORMATION CONTACT: Dan Sullivan, Public Policy Analyst, Office of Multifamily Assistance Restructuring, Department of Housing and Urban Development, 1280 Maryland Ave., Suite 4000, Washington DC 20024, 202–708–0001. (This is not a toll-free number.) For hearing-and speech-impaired persons, this number may be accessed via TTY by calling the Federal Information Relay Service at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

I. Background

A. Mark-to-Market

HUD issued an interim rule on September 11, 1998 (63 FR 48926) to implement subtitles A and D of MAHRA (the Multifamily Assisted Housing Reform and Affordability Act of 1997, title V of Pub. L. 105–65 (approved October 27, 1997), 42 U.S.C. 1437f note.

MAHRA authorized a new Mark-to-Market Program designed to preserve low-income rental housing affordability while reducing the long-term costs of Federal rental assistance, including project-based assistance from HUD, for certain multifamily rental projects. The projects involved are projects with: (1) HUD-insured or HUD-held mortgages; and (2) contracts for project-based rental assistance from HUD, primarily through the section 8 program, for which the average rents for assisted units exceed the rent of comparable properties. The program objectives will be accomplished by (1) reducing project rents to no more than comparable market rents (with certain exceptions discussed below), (2) restructuring the HUD-insured or HUD-held financing so that the monthly payments on the first mortgage can be paid from the reduced rental levels, (3) performing any needed rehabilitation of the project, and (4) ensuring competent management of the project. The restructured project will be subject to long-term use and affordability restrictions.

MAHRA is intended to provide a long-term solution to the rapidly growing cost to the Federal Government of assisting affordable rental housing. Over 900,000 housing units in approximately 10,000 multifamily projects have been financed with FHA-insured mortgages and supported by project-based section 8 housing assistance payment (HAP) contracts. In many cases, these HAP contracts currently provide for rents for assisted units that substantially exceed the rents for comparable unassisted units in the local market. Starting in Fiscal Year 1996, those contracts began to expire, and Congress and the Administration began providing 1-year extensions of expiring contracts. While annual HAP contract extensions for these projects maintained an important affordable housing resource, they came at great expense. Every year more contracts expired, compounding the cost of annual extensions.

To begin to address this growing problem, Congress authorized demonstration programs beginning with section 210 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1996 (see HUD notices regarding the demonstrations published at 61 FR 34664 (July 2, 1996), 61 FR 28757 (July 25, 1996), 62 FR 3566, (January 23, 1997) and 63 FR 36130, (July 1, 1998)). MAHRA builds on the demonstration programs with similar objectives and many similar provisions, but also some significant differences.

Organizationally, MAHRA established within HUD a new Office of Multifamily Housing Assistance Restructuring (OMHAR) to develop and actively manage, administer, and oversee the Mark-to-Market Program through a decentralized structure of Participating Administrative Entities (PAEs). OMHAR has established the framework of the Program through an interim rule, this final rule, and an Operating Procedures Guide, and is managing the program by selecting and monitoring Participating Administrative Entities (PAEs). In recognition of limited HUD resources, MAHRA gives PAEs the role of negotiating with the owners of individual projects and developing the Mortgage Restructuring and Rental Sufficiency Plans (Restructuring Plans) that will establish the future responsibilities of the owner, the PAE and HUD for projects that are marked-to-market. MAHRA also contains substantive differences from the previous demonstrations. For example, it includes projects with HUD-held mortgages in addition to HUD-insured mortgages and requires a second mortgage with deferred payment from net cash flow after accounting for all project expenses.

The preamble to the interim rule outlined implementation steps taken through September 11, 1998. Since then, the Senate confirmed President Clinton's appointment of Ira G. Peppercorn as the Director of OMHAR. OMHAR is currently hiring staff, and has established its Headquarters at 1280 Maryland Avenue SW, Suite 4000, Washington D.C. 20024. OMHAR Regional Offices have been established in New York, Chicago, and San Francisco. A Regional Office co-located in OMHAR Headquarters has full responsibility for the Southeast.

Before publication of this final rule, HUD was required to conduct at least three public forums at which organizations representing various groups may express views concerning HUD's proposed disposition of recommendations from those groups (specifically, the recommendations for certain provisions of MAHRA that were implemented in §§ 401.200, 401.201, and 401.420 of the interim rule.) The Department conducted these forums in New York, Chicago, and San Francisco on October 1, 1998. Forum participants representing a variety of interests made presentations that expanded and clarified written comments on both the matters covered in the section identified above, and other topics related to the Department's implementation of the Mark-to-Market Program. The vast majority of the issues discussed at the forums have been raised in one or more written public comments and will be addressed in the context of the written submissions. Thus, the issues raised at

the public forums will not be independently addressed in the preamble to this final rule. Written public comments in response to the Interim Rule were due October 26, 1998. In addition to the public forums, OMHAR convened a focus group on November 18, 1998, in Washington D.C. This meeting was helpful to OMHAR in hearing discussion and debate between commenters concerning several controversial policy issues contained in the regulations.

HUD issued a Request for Qualifications (RFQ) for eligible entities interested in being Participating Administrative Entities, 63 FR 44102, August 17, 1998. A bidders conference was held August 27, 1998, and submissions were due September 16, 1998. OMHAR identified 52 Public Entity applicants and 11 Non-Public applicants as meeting the PAE technical qualifications. All Public Entity applicants were informed by January 19, 1999, and all Non-Public applicants were informed by July 2, 1999. OMHAR provided an initial technical assistance briefing for potential PAEs on January 12, and 13, 1999. OMHAR has conducted an orientation session for each PAE after its Portfolio Restructuring Agreement (PRA) was signed. Each PAE also participated in one of five 2-day technical assistance sessions addressing underwriting issues. OMHAR will conduct additional training for PAEs in the upcoming months. OMHAR is continuing to negotiate PRAs with the public PAEs that have not yet executed a PRA. OMHAR expects each asset submitted by an owner for restructuring to be allocated to a PAE by the end of 1999.

MAHRA authorizes $10 million per year of technical assistance funding to tenant and non-profit groups, and public entities. These funds will be used to build tenant capacity to participate meaningfully in the Mark-to-Market program by organizing and training (OTAG grants), and to provide technical assistance to tenants of specific Mark to Market properties (ITAG grants). The initial funding for FY 1999 was awarded through the Department's SuperNOFA process, and grant agreements were executed in January 1999. OMHAR conducted training for the ITAG and OTAG grantees on November 30, December 1, and 2, 1998.

A general brochure explaining the basic program features is being prepared and will be distributed to tenant groups and other interested stakeholders. Once published, copies may be obtained by calling the Multifamily Housing Clearinghouse at 1–800–685–8470, or downloaded from OMHAR's Webpage at http://www.hud.gov/omhar. OMHAR and the Office of Housing conducted a distance learning seesion on September 21, 1999. In addition to the training already conducted, OMHAR will be conducting distance learning and on-site training for PAEs, HUD Field Offices, and other interested parties in the upcoming months.

The Mark-to-Market Program Operating Procedures Guide has been completed and made available to the public. OMHAR will make additional information on the Mark-to-Market Program available on its Webpage. Among other information, OMHAR has provided a list of addresses of OMHAR Regional Offices with jurisdiction over the Program, a list of PAEs that have been selected, the list of assets assigned to PAEs, and a list of Intermediary Technical Assistance Grant (ITAG) and Outreach and Training Grant (OTAG) providers and contact persons for technical assistance grants related to Mark-to-Market Program restructuring.

B. Renewing Section 8 Project-Based Assistance Without Mark-to-Market Restructuring

Section 524 of MAHRA and part 402 of the interim rule authorize renewal of expiring section 8 project-based assistance contracts for projects without Restructuring Plans under the Mark-to-Market Program, including projects that are not eligible for Plans and eligible projects for which the owners request contract renewals without Plans. At this final rule stage, we are separating parts 401 and 402. Minor changes are made in this final rule to §§ 402.1, 402.4, and 402.6. The rest of interim part 402 continues in effect until other changes to part 402 are published later as a separate final rule.

C. Changes in Legislation

After MAHRA became law, Congress enacted the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (Pub. L. 105–276, approved October 21, 1998) and the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act 2000 (Pub. L. 106–74, approved October 20, 1999). The first law amended the underlying statutory authorization for some provisions in the interim rule. HUD issued two corrections to the interim rule, on October 15, 1998 (63 FR 55333) and December 28, 1998 (63 FR 71372). The second correction included one change to part 402 to incorporate a provision of Pub. L. 105–276. Other changes needed to reflect Pub. L. 105–276 are included in this final rule and discussed in Section III of this preamble.

Pub. L. 106–74 also changed the underlying statutory authorization for some provisions in the interim rule. The most extensive changes affect provisions in part 402 and will be dealt with in separate rulemaking. Statutory changes related to part 401 are included in this final rule, as discussed in part III of this preamble, to the extent possible in a final rule.

In deciding what statutory changes can and should be reflected in this final rule, HUD considered its general rulemaking procedures in 24 CFR part 10, the provisions of section 502 and section 503 of Pub. L. 106–74, and the provisions of section 522 of MAHRA. Section 503 makes the new changes to section 524 of MAHRA effective immediately upon enactment (October 20, 1999) and states that the authority to issue regulations (*e.g.,* in section 502) may not be construed to affect the effectiveness or applicability of provisions such as section 524. The newly-effective section 524(g) of MAHRA applies the amended section 524 to all contract expirations or terminations on October 1, 1999 or afterwards. Thus, HUD must promptly take appropriate action that recognizes that some of the matters covered in interim part 402 have changed.

Section 502, however, requires that any implementing regulations that the Secretary determines ''may or will affect tenants of federally assisted housing'' may be issued only after notice and comment rulemaking. Ordinarily, HUD has the discretion under 24 CFR part 10 to issue substantive changes to regulations for effect, without notice and comment rulemaking (*i.e.,* through an interim or final rule), if HUD determines that a public comment period before effectiveness is unnecessary, impracticable, or contrary to the public interest. Section 502 limits this discretion.

Finally, section 522 of MAHRA (enacted in 1997), which directed HUD to implement section 524 of MAHRA by interim and then final rule, was not expressly amended. HUD is already overdue in issuing the final rule required by that section. But HUD cannot now proceed to replace the interim rule with a final rule without recognizing the intervening changes to section 524 that are now in effect but are inconsistent with various provisions of the interim rule.

There is no clear guidance in the statutes on how to reconcile the later instructions on rulemaking procedure in section 502—which apply not only to

MAHRA changes, but to many unrelated programs such as the section 202 and section 811 assisted housing programs—with earlier instructions on rulemaking procedure that apply to specific provisions of MAHRA. In this final rule, HUD has reconciled those sections by applying the following five principles:

1. HUD should continue to honor Congressional intent for rapid final implementation of the Mark-to-Market Program, in accordance with section 522 of MAHRA, by publishing part 401 in final form as soon as feasible.

2. Provisions in the interim part 401 that conflict with later amendments to MAHRA should not be published in final form without making conforming changes, to avoid confusion and facial conflict with current statutory provisions.

3. Conforming changes that simply reproduce or paraphrase new statutory language do not ''affect'' tenants within the meaning of section 502, since any effect derives from the statute rather HUD's rulemaking. Thus, section 502 does not require a new proposed rule for such changes.

4. Conforming changes that simply reproduce or paraphrase new statutory language also do not have substantive effect on tenants, owners or others that would require prior notice and comment rulemaking under 24 CFR part 10. Such procedure is properly regarded as both unnecessary and contrary to the public interest.

5. Any changes to the interim rule that are made in response to new statutory language but that make substantive additions to the statutory provisions should be made only through a separate notice and comment rulemaking procedure commencing with a proposed rule—in accord with 24 CFR part 10 and (to the extent the substantive additions may affect tenants) section 502. Thus, no such changes should be included in this final rule.

D. Other Background Information

This final part 401 is based on HUD's consideration of: (1) Public comments received on the September 11, 1998, interim rule; (2) discussions at the public forums; (3) the initial development of working relationships with PAEs; and (4) certain provisions in Pub. L. 105–276 and Pub. L. 106–74 as mentioned above. HUD has also refined certain policies due to further consideration when preparing and revising the Mark-to-Market Program Operating Procedures Guide (called the ''Operating Procedures Guide'' in this preamble.)

The interim rule was signed by Secretary Andrew Cuomo in the absence of an OMHAR Director. OMHAR has now begun operations, and OMHAR Director Ira Peppercorn has statutory authority to sign this final rule because it is limited to part 401 and projects eligible for the Mark-to-Market program. As required by section 573(b) of MAHRA, this rule is issued with the approval of Secretary Cuomo.

II. Comments Received on Part 401

We received 61 comments that are included in the docket file for the interim rule. We disregarded five comments as not pertinent to the interim rule. The discussion in this section of this preamble summarizes the other comments and HUD's responses to them, except that a comment that pertained solely to part 402 of the interim rule, and HUD's response, will appear when part 402 is published as a separate final rule. In this section, we have grouped the sections of interim part 401 into major areas of related subject matter, as shown in the outline set forth below. Discussion is generally in the order in which the areas are first covered in interim part 401. We have not listed the sections that received no public comments.

A. §§ 401.2, 401.99 and 401.100, General provisions and eligibility.

1. Definitions (§ 401.2).
   a. Eligible project.
   b. Eligible project costs.
   c. Priority purchaser.
   d. Tenant organization.
2. Actions needed to request a renewal of project-based assistance (§ 401.99).
3. Projects eligible for a Restructuring Plan (§ 401.100).
   a. 236/202 projects.
   b. Preservation projects.

B. §§ 401.101 and 401.403, Rejection of project or owner.

1. Designation as ''bad'' project.
2. Designation as ''bad'' owner.
3. Treatment of civil rights violations.
4. Project transfers to ''good'' owners.

C. §§ 401.200, 401.200 and 401.304, PAE selection and compensation.

1. Civil rights violations.
2. PAE compensation.
   a. Incentives.
   b. Timing of HUD payments.
   c. Same fee schedule for public and private PAEs.
   d. Environmental review responsibilities.

D. §§ 401.303, 401.309, 401.310, and 401.314, Other provisions of PRA.

1. Indemnification of non-public PAEs (§ 401.303).
2. PRA term and termination provisions (§ 401.309).
   a. Term should be longer than 1 year.
   b. PRA terminations.
3. Conflicts of interest (§ 401.310).
   a. General.
   b. Contested matters.
4. Environmental review responsibilities (§ 401.314).

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

F. §§ 401.405–.406, Restructuring Commitment.

G. § 401.408, Affordability and use restrictions required.

1. Use restrictions and partially-assisted projects.
2. Use Agreements should last ''exactly'' 30 years—not ''at least'' 30 years.
3. If no section 8 funds are available, owners should be required to charge restructured rents or below-market LIHTC rents.
4. There should be no below-market rents.
5. Enforceability of Use Agreements and notice.
6. Pre-existing Use Agreements should be preserved.
7. Use Agreement should be subordinate to conventional loan.
8. Renewal contract terms must remain materially the same.

H. §§ 401.410–.412, Determining and adjusting rents under restructuring with project-based assistance.

1. Difficulties in determining comparable market rents.
2. ''Blended'' rents considering unassisted but restricted units.
3. Objections to ''NOI project'' and ''positive social asset'' requirements for exception rents.
4. Exception rents should be alternative to FMR.
5. Limitation of exception rents to 120 percent of FMR.
6. Need to define ''community''.
7. Other factors to be included in expenses.
8. Determination of OCAF.
   a. General.
   b. Excluding debt service.
9. Negative OCAF.
10. Appeals of OCAF.

I. §§ 401.420–.421, Project-based assistance or tenant-based assistance.

1. What vacancies should be considered in determining the presence of a tight market?
2. Effect of sale to cooperative.
3. Limit conversion approvals to public body PAEs.
4. Requirement for semi-annual reporting in § 401.421(d).
5. How should the final rule handle/present factors to be considered in the Rental Assistance Assessment Plan?
6. Must all units be assisted under a Restructuring Plan?

J. § 401.450–.453, Physical condition of project.

1. Use of FNMA PNA Guidelines should not be eliminated.
2. The final rule should make clear that third party expenses for physical condition evaluation are eligible expenses.
3. Lead hazards.

4. Reserve account deposit.
5. Concern about cost-effectiveness determination in § 401.451(c).
6. PAE certification.
7. Property standards for rehabilitation.
8. HQS should not apply to non-assisted market rent units.

K. §§ 401.460–.471, Mortgage restructuring and payment of claims.

1. How should net operating income available to pay the first mortgage be determined?
   a. Expenses.
   b. Sizing the first mortgage.
2. First mortgage terms and conditions.
3. Refinancing.
4. Second mortgage terms and conditions.
   a. Interest rate.
   b. Other terms and conditions.
5. Forgiveness/modification of second mortgage.
6. Return to owner.
7. Third mortgage.
8. Claims.

L. §§ 401.472–.473, Funding of rehabilitation.

1. Opposition to 20 percent owner contribution requirement.
2. Opposition to limit on funding from governmental resources.
3. Other comments regarding 20 percent requirement.
4. Comments regarding use of project accounts for rehabilitation.
5. Section 236(s) rehabilitation grants.
6. Funding of rehabilitation through claim amount.

M. § 401.480, Sale or transfer of project.

1. HUD should be responsible for sale of projects.
2. Preference for priority purchasers.
3. Priority purchasers and competitive sales.

N. §§ 401.481-.484, Other requirements of Restructuring Plan.

1. Subsidy layering limitations on HUD funds (§ 401.481).
2. Leasing units to voucher holders (§ 401.483).
3. Property management standards (§ 401.484).
   a. General comments on changes needed.
   b. Suggestions for language changes.
4. Management fees.

O. §§ 401.500–.501, Participation by tenants, community and local government.

1. General.
2. Involve others in Rental Assistance Assessment Plan.
3. Intermediaries administering technical assistance grants should receive notice.
4. Notices in other languages.
5. Notice to all tenants and posted in project.
6. Right to organize.
7. Tenant role in PAE selection.
8. Rent levels.
9. Use Agreement changes.
10. Monitoring and compliance activities.
11. Transfer of properties and tenant participation.
12. Tenant involvement for projects not restructured.
13. Access to information.

P. §§ 401.550–.554, Implementation of the Restructuring Plan after closing.

1. Inspections.
2. PAE matters.
3. Role of lender.
4. Servicing of second mortgage.
5. Section 8 contract administration.
6. Enforcement.

Q. § 401.595, Contract provisions.

R. § 401.601 of interim rule and § 402.4(a)(2) of final rule, Consideration of an owner's request to renew an expiring contract without a Restructuring Plan.

1. Determination/verification of rent comparability.
2. Determining adequacy of DSC at market comparable rents.

S. § 401.602, Tenant protection if an expiring contract is not renewed.

1. Is tenant-based assistance mandatory?
2. Notice issues.
   a. 6-month notice of non-renewal.
   b. When is notice required?
3. Rent levels for tenant-based assistance.
4. Timing of tenant-based assistance.

T. § 401.606, Tenant-based assistance provisions for displaced tenants.

U. §§ 401.645 and 401.651, Owner dispute of rejection and administrative appeals.

1. Tenant appeals.
2. PAE appeals of rejections under § 401.405.
3. Time for owner to dispute approved plan.
4. Owner appeals.

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

W. Miscellaneous comments.

A. Sections 401.2, 401.99 and 401.100, General Provisions and Eligibility

Summary of Sections

Section 401.2 identifies the terms that are defined in MAHRA and used in the rule, and defines additional terms that are used in the rule. Section 401.99 explains three procedures to be followed by owners who request renewals of section 8 project-based assistance contracts. First, an owner of an eligible project who requests a Restructuring Plan must, at least 3 months before the project-based assistance contract expires, certify to HUD that, to the best of the owner's knowledge, project rents exceed comparable market rents and neither the owner nor any affiliate is suspended or debarred (or that the owner proposes a voluntary sale of the project). Second, an owner of an eligible project who does not request a Restructuring Plan must submit to HUD the certification described above in the same time frame, with the additional items that will permit the PAE to consider the request in accordance with § 401.601 of the interim rule (§ 402.4(a)(2) in this final rule) to determine whether the contract should be renewed under § 402.4. Finally, because part 401 is limited to projects eligible for a Restructuring Plan, this section of the interim rule refers the owner to § 402.5 if the project is not eligible for restructuring but the owner wants project-based assistance renewed.

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

Summary of Comments

1. Definitions (§ 401.2).

a. Eligible project. Two commenters felt that the definition of ''eligible project'' in the interim rule would require restructuring for projects whose aggregate rents might not exceed comparable market rents, contrary to Congressional intent, because rent levels for non-assisted units would not be considered in preservation projects or similar projects with unassisted below-market units and above-market section 8 units.

HUD response: Preservation projects are discussed in the response under Section II.A.3.b. They are no longer eligible for the Mark-to-Market Program.

b. Eligible project costs. One commenter felt that eligible project costs should include the costs to owners of hiring advisors such as accountants, appraisers, attorneys, real estate specialists, or tax advisors. The commenter argued that many owners are confused and uninformed about the details and impact of MAHRA and that they have limited funds to seek advice.

HUD response: Such transaction costs can be included in the mortgage restructuring to the extent reasonable and necessary and supportable within a refinancing first mortgage (though not in a modification of the existing first mortgage). If the refinancing mortgage is insured by FHA, normal FHA criteria would be applied. Generally, OMHAR will recognize 50 percent of such costs to the extent they are customary, reasonably necessary, and to the extent they are otherwise acceptable under the terms of the new restructured first mortgage. The owner's share of such costs could only be recognized as

project operating expenses to the extent there was sufficient cash flow in the fiscal year during which the restructuring took place and then only with written approval from the HUD Multifamily Hub or Program Center.

c. Priority purchaser. Three commenters were concerned about the definition of ''priority purchaser''. One felt that the definition should include non-tenant based nonprofit organizations and non-community based nonprofit organizations because many of these groups possessed considerable experience with low-income housing and would be important resources in preserving low-income housing. Two commenters suggested that the final rule clarify that a tenant organization or tenant-endorsed community-based nonprofit or public agency can, as a controlling general partner in a limited partnership formed to raise tax credit equity, retain its priority purchaser status through the partnership, as well as the related ability to qualify for second mortgage forgiveness.

HUD response: HUD agrees that a limited partnership with a sole general partner that is a tenant organization or tenant-endorsed community-based non-profit organization or public body may be viewed as a priority purchaser for purposes of § 401.461(b)(5) (possible forgiveness or modification of HUD-held second mortgage upon sale of project to priority purchaser) and § 401.480 (preference for sale to priority purchaser when current owner found ineligible for restructuring). HUD does not agree with the suggestion that priority purchasers should include national non-profit organizations without a local community base. There are national groups that can bring experience, but they should either partner with a local group, or else need to compete with other potential purchasers after the period reserved for marketing exclusively to priority purchasers, which will initially be set at 4 months. The applicable statutory provisions (sections 516(e) and 517(a)(5) of MAHRA) clearly show a Congressional desire for community-basing in this context.

d. Tenant organization. One commenter suggested that the definition of ''tenant organization'' in the final rule should clarify the details of the election of tenant organization officers to avoid future disputes as to whether an organization is a tenant organization entitled to recognition.

HUD response: This level of detail is inappropriate and unnecessary for a rule. HUD will address organizational details as needed in the Operating Procedures Guide or subsequent guidance.

2. Actions needed to request a renewal of project-based assistance (§ 401.99).

One commenter pointed out that ordinarily a project has 60 days to complete the annual financial statement and that requiring the statement during this period may cause difficulties for owners. The commenter suggested that, in such instances, the preceding year's financial statement should be acceptable. The same commenter suggested that the reference in § 401.99(c) to § 402.5 should be expanded to include § 402.4 because a project can have its contract extended under § 402.4 if the owner desires. One commenter said that notice of intent to restructure should be given to mortgagees.

HUD response: The most recently required financial statement must be provided. If the renewal request and expiration is within the 60 day period following the end of the project's fiscal year, the previous year's statement will be accepted. We have added the suggested reference to § 402.5. A project owner must give notice to mortgagees of intent to restructure. This is stated in the interim rule's preamble discussion of § 401.99, and is clearly required in the Operating Procedures Guide. We consider such notice part of the owner cooperation required by § 401.402.

3. Projects eligible for a Restructuring Plan (§ 401.100).

a. 236/202 projects. One commenter requested clarification of whether the class of ''236/202'' projects are eligible under MAHRA. (These projects were originally processed under the section 202 program but converted to the section 236 program after its creation in 1968.)

HUD response: Section 236/202 projects are eligible in the same manner as other section 236 projects.

b. Preservation projects. One commenter argued that MAHRA should be interpreted to exclude from eligibility preservation projects with plans of action (under ELIHPA or LIHPRHA). The commenter pointed out difficulties in reconciling MAHRA's requirements for restructuring with promises made to owners in ELIHPA/LIHPRHA plans of action, such as the short term use agreements and the unrestricted return to owner approved by HUD under ELIHPA. (Other comments related to preservation projects are mentioned in the summaries in Sections II.A.1.a., II.H.2., II.H.7., and II.K.1 of this preamble, and the response below applies to those comments as well).

HUD response: Section 531(b) of Pub. L. 106–74 amended MAHRA to make preservation projects with plans of action ineligible for the Mark-to-Market program. This statutory change automatically excludes these projects from the ''eligible projects'' definition in the interim rule. No change in rule language is needed to make the final rule comply with the statutory change.

B. Sections 401.101 and 401.403, Rejection of Owner or Project

Summary of Sections

These sections implement section 516(a) of MAHRA, which permits HUD to elect to not consider a restructuring plan or a request for contract renewal on the basis of certain actions or omissions by an owner or purchaser of the project or an affiliate, or if the PAE determines that the poor condition of the project cannot be remedied in a cost-effective manner. Under § 401.101, HUD and PAEs will not consider the request of an owner of an eligible project for a Restructuring Plan if the owner or an affiliate is debarred or suspended by HUD unless a sale or transfer of the property is proposed in accordance with § 401.480. The final rule makes a change to § 401.101 regarding affiliates, consistent with the § 401.403 change discussed below.

Under § 401.403 of the interim rule, the PAE is responsible for a further more complete and ongoing assessment of owner and project eligibility while a Restructuring Plan is developed. The PAE must inform OMHAR if: (1) The owner or an affiliate is debarred or suspended; (2) the owner or an affiliate has engaged in material adverse financial or managerial actions or omissions as described in section 516(a) of MAHRA, which may include actions that have resulted in imposition of a Limited Denial of Participation (LDP) or a proposed debarment under 24 CFR part 25, or outstanding violations of civil rights laws; or (3) the PAE determines that the project does not meet the physical condition standards in § 401.453 and cannot be rehabilitated to meet such standards in a cost-effective manner. Under the interim rule, HUD may reject an owner's request for a Restructuring Plan for any of these reasons. In the final rule, debarment or suspension of an owner are automatic grounds for rejection under § 401.403 unless an acceptable sale is proposed. We revised the rule to give HUD discretion whether to accept or reject an owner request for restructuring if an affiliate of the owner is suspended or debarred. When rejection is discretionary, HUD may advise the PAE

to continue processing (under part 401) or decide to continue processing itself (under part 402).

Summary of Comments

1. Designation as ''bad'' project. One commenter suggested that the rejection of a ''bad project'' because of poor condition that cannot be remedied in cost-effective manner needs to be guided by an objective standard of cost-effectiveness (the commenter suggested a standard).

HUD response: HUD does not agree with this commenter that an objective elaboration on the cost-effectiveness requirement is feasible for inclusion in the final rule. The specific facts and circumstances must be considered by the PAE and OMHAR. The appeal process provided in subpart F is available if there is a dispute.

2. Designation as ''bad'' owner. HUD should not reject an owner for a suspension/debarment if the owner's appeal is not yet adjudicated, argued two commenters. One of these commenters also objected to basing a ''bad owner'' rejection on a limited denial of participation (LDP) or proposed debarment alone because such actions might not be ''material'' within the meaning of section 516(a) of MAHRA). The commenter suggested that a PAE should examine the facts behind a LDP/proposed debarment and reach its own conclusion regarding materiality.

HUD response: The rule is consistent with these comments. ''Bad owner'' determinations are made on the basis of ''material adverse financial or managerial actions or omissions'' identified in section 516(a)(2) of MAHRA. In the final rule, the Department has decided that an actual suspension or debarment will always be material for purposes of eligibility for a Restructuring Plan. HUD and PAEs are required to make a determination of materiality before rejecting an owner if a debarment or suspension decision has not already been made by HUD.

3. Treatment of civil rights violations. Two commenters wanted civil rights violations to be considered in a ''bad owner'' determination only if they have been finally adjudicated and have not been substantially cured. One of these commenters commented on a need to clarify which violations are disqualifying civil rights violations.

HUD response: Civil rights violations will be addressed by OMHAR after consultation with HUD's Office of Fair Housing and Equal Opportunity. The Operating Procedures Guide details the decision-making process regarding owner eligibility for a Restructuring Plan, including the point at which an apparent outstanding civil rights violation will constitute a bar to further consideration of a Restructuring Plan for the owner. The Operating Procedures Guide provides further information on the civil rights legal authorities that will be considered when making a determination of owner eligibility.

4. Project transfers to ''good'' owners. Four commenters thought that the rule was deficient in its treatment of project transfers after ''bad owner'' determinations. One labelled the interim rule's provisions providing for rejection of certain owners a ''misguided policy of forced voucherization'' and wanted the final rule to reiterate that contract termination is a last resort and that transfer to a priority purchaser is preferable to conversion. Two others cited a statement by Senator Bond regarding the need for alternative solutions for projects when an owner is disqualified.

HUD response: The commenters who thought that the rule was deficient did not suggest specific improvements to the rule. The determination to deny a restructuring or to not renew the project-based assistance will be made on a case-by-case basis. The PAE and HUD will consider the impact on tenants, the potential to transfer the project to priority purchasers, and other remedies. The PAE will invite tenant and local community participation and solicit comments in accordance with §§ 401.500 and .501 of the final rule.

C. Sections 401.200, 401.201 and 401.304, PAE Selection and Compensation

Summary of Sections

Section 512(10) of MAHRA, referenced in § 401.200, permits a public agency, a nonprofit organization, or a for-profit entity, to be a PAE. Under § 401.200, the PAE may not have any outstanding violations of civil rights laws, determined in accordance with criteria in use by HUD. Section 401.201 explains that HUD will select PAEs in accordance with the statutory selection criteria and additional selection criteria established by HUD. The selection method will be determined by HUD and may be through a request for qualifications (RFQ). Section 401.304 provides that the PRA will contain provisions on compensation to the PAE regarding a base fee and reimbursement of expenses, and may provide for incentive fees.

Summary of Comments

1. Civil Rights violations. One commenter had due process concerns with requiring that a potential PAE have no outstanding violations of civil rights laws. This commenter recommended that potential PAEs should not be disqualified unless the civil rights violations are material and the result of a final adjudication. In addition, this commenter felt that violations that have been substantially cured should not become grounds for disqualification.

HUD response: Please see HUD's response under Section II.B.3. on a similar point.

2. PAE compensation.

a. Incentives. One commenter felt that it was important to have full and early public disclosure of incentives to PAEs in order to ensure public confidence in the fairness and objectivity of the restructuring process. Three commenters felt that PAE incentives should reflect the statutory intent that economic and non-economic objectives be balanced. One of these commenters suggested incentives similar to those offered PAEs in the Portfolio Reengineering demonstration programs.

HUD response: The specific details of PAE compensation will be included in the PRA. They are not appropriate for inclusion in regulations since compensation will be subject to revision from time to time. The details of the PAE compensation package will be fully disclosed when the ongoing negotiations with the remaining PAEs without PRAs are concluded. The compensation for private PAEs is determined through a competitive bidding process. The incentive section of the compensation package has been set up to balance the preservation and cost savings goals of the Mark-to-Market Program. The compensation package of the demonstration program is being carefully considered as OMHAR finalizes the PAE compensation package for the permanent program.

b. Timing of HUD payments. One commenter urged HUD to provide PAEs with a significant portion of their fees early in the restructuring process.

HUD response: We do not agree that this would be necessary or appropriate. Funds for fees and reimbursable expenses will be released commensurate with completion of work.

c. Same fee schedule for public and private PAEs. One commenter was concerned about differing fee schedules for public and private PAEs. This commenter felt that a differing fee schedule might lead HUD to choose private PAEs in order to save money, thus contradicting the Congressional mandate to utilize public agencies whenever possible to protect the public interest.

HUD response: The statute, the regulations, and HUD's implementation of the program have all been consistent with expressed Congressional intent that public entities have a priority in OMHAR's selection process for a PAE within a geographic jurisdiction.

d. Environmental review expenses. Two commenters noted that the interim rule indicated that the PAE may be expected to assist HUD in complying with HUD's environmental review responsibilities by completing certain forms or checklists. Both commenters suggested that HUD should clarify that any outside expense incurred by PAEs in completing these forms should be considered a reimbursable expense.

HUD response: Such expenses will be reimbursable subject to the terms of the PRA.

D. Sections 401.303, 401.309, 401.310 and 401.314, Other Provisions of PRA

Summary of Sections

Section 401.303 implements section 513(a)(2)(G) of MAHRA, which requires HUD to provide a PAE indemnity against lawsuits and penalties for action taken by a PAE pursuant to the PRA (except for willful misconduct or negligence) if the PAE is a State housing finance agency or a local housing agency. Under § 401.309, the PRA will have a term of 1 year, to be renewed for successive terms of 1 year with the mutual agreement of both parties. A PRA will be subject to termination by HUD at any time.

Section 401.310 addresses conflicts of interest for a PAE and related persons defined in the section as ''restricted persons''. A conflict of interest exists when a PAE or restricted person either: (1) Has personal, business, or financial interests or relationships that would lead a reasonable and knowledgeable person to question the integrity or impartiality of those acting for the PAE; or (2) in a lawsuit, is an adverse party either to HUD or to the owner of a project under the PAE's PRA. In general, HUD will avoid dealing with a PAE with a conflict of interest.

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

Summary of Comments

1. Indemnification of non-public PAEs (§ 401.303).

One commenter felt that HUD should indemnify non-public PAEs. The commenter argued that while section 513(a)(2)(G) of MAHRA specifically requires HUD to indemnify public PAEs, section 517(b)(5) gives HUD broad authority to provide indemnification to non-public PAEs as well. This commenter asserted that the same policy reasons that justify indemnification of public PAEs argued in favor of indemnifying non-public PAEs. Finally, the commenter thought that HUD should make clear in the final regulation that a PAE may indemnify a non-public team partner, if it so chooses.

HUD response: HUD will indemnify only public entity PAEs. Although PAEs may choose to indemnify teaming partners, such indemnification will not be a reimbursable expense and PAEs may not pass on this cost to OMHAR or HUD. There is no prohibition in MAHRA against PAEs indemnifying teaming partners or subcontractors and, accordingly, this will not be addressed in the final rule.

2. PRA term and termination provisions (§ 401.309).

a. Terms should be longer than 1 year. One commenter pointed out that preparing an application to become a PAE takes considerable time and effort, and that learning and becoming expert at fulfilling the requirements of the PRA requires significant additional effort. The commenter felt that 1 year would not provide an adequate opportunity for HUD to determine the PAE's capacity. Another commenter felt that the short term would interfere with owner ability to develop long-term relationships with a PAE. The commenter suggested that the terms should be indefinite after the first year. A third commenter had two concerns about the PAE renewal process: that yearly PRA renewals would lead to another burdensome and unnecessary PAE selection process, and that HUD might use the annual review process to replace HFAs with non-public entities because the one-time priority for public entities would not apply after the initial selection. The commenter argued that Congress did not intend for HUD to use public agencies as PAEs only for the first year, and discouraged HUD from trying to circumvent Congress' intent by creating a new PAE selection process in the later years of the program.

HUD response: If 1 year is not adequate to determine a PAE's capacity, HUD will extend the contract for an additional year. Except in the presumably unusual cases where a PRA was terminated and the assets reassigned to another PAE or to OMHAR itself, the PAE will continue to process the particular projects agreed upon by HUD and the PAE. A 1-year contract term is appropriate both in order to revise provisions as necessary based on experience, and as an administrative convenience for the Department. OMHAR's intent is to renew PRAs with PAEs unless there are performance or capacity problems or there is mutual agreement not to continue.

b. PRA terminations. One commenter felt that the rule appeared to allow termination with or without cause, and that terminations without cause would cause PAEs to adopt a short-term perspective detrimental to restructuring. This commenter suggested only allowing termination for cause and providing appropriate due process protection. Another commenter agreed that termination should only be for cause and ''only in extraordinary circumstances''. One commenter was concerned that HUD could terminate a PRA at any time for cause but that a PAE could not, and that rights to termination for cause should be mutual because Congress intended HUD and PAEs to be partners.

HUD response: The PRA includes a bilateral right to termination for convenience and is therefore in keeping with the partnership goal. Were OMHAR to exercise this right the PAE would be paid, at a minimum, for services rendered to the point of the termination. We do not believe that the termination for convenience provision of the rule will reasonably affect the PAE's perspective on the PRA or restructuring work.

3. Conflicts of interest (§ 401.310).

a. General. A number of commenters expressed concerns about the conflict of interest rules. One commenter felt that HUD should be able to waive a conflict involving a potential PAE who is taking an adverse position to an owner, if the owner consents, because it is the owner who is at risk of being damaged. One commenter felt that the conflicts of interest rule was overbroad. This commenter argued that HFAs often work with the same principals in different roles and that an HFA should not be penalized for having legitimate business contacts that do not interfere with their objectivity as a PAE. This commenter suggested that HUD narrow the scope of the conflict of interest provisions so that they apply only to specific properties undergoing restructuring. This commenter also felt that the conflict of interest provisions

would make it difficult for a PAE to provide an owner with other available resources, such as Low Income Housing Tax Credits, HOME funds, and risk-sharing loans, which is unnecessary because HFAs utilize strict, objective allocation plans for these resources.

HUD response: The conflict of interest provisions are drafted to protect OMHAR and the public interest while allowing flexibility to accommodate varying factual situations. In order to prevent unfairness in particular cases and to allow PAEs to provide owners with other available resources, all waiver requests will be considered carefully. As deemed appropriate on a case-by-case basis, OMHAR will seek information from outside sources when considering conflict of interest determinations and waiver requests.

b. Contested matters. Two commenters felt that any lawsuit in which a PAE and an owner were adversaries should automatically be considered a conflict of interest and the PAE should automatically be disqualified from exercising any responsibilities under the regulations with regard to that owner. One of these commenters also felt that the final rule should allow owners and other interested parties to seek HUD review of potential conflicts of interest, in addition to the PAE. One commenter asked whether and why a disqualifying conflict of interest would apply, not only to a party to a lawsuit or contested matter, but also to any legal counsel representing such a party. This commenter also felt that the final rule should more fully define the scope of the terms ''administrative proceeding or other contested matter'' and ''adverse to HUD.''

HUD response: Any lawsuit in which a PAE and an owner are adversaries will be considered a conflict of interest. It will trigger scrutiny and will necessitate a waiver prior to the PAE beginning or continuing work on a Restructuring Plan. OMHAR will carefully investigate conflict of interest allegations or disclosures that are raised by any source. The Operating Procedures Guide and OMHAR's Internet Website provide more information on the specifics of OMHAR's conflict of interest requirements, including affected parties and definitions of terms.

4. Environmental review responsibilities (§ 401.314).

One commenter felt that, if the restructured first mortgage is refinanced with a conventional loan, then HUD should delegate all required environmental reviews to the conventional lender.

HUD response: Current law does not permit HUD to delegate environmental review responsibilities to a lender.

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

Summary of Section

This section provides guidance for implementation of the requirement in section 514(a)(2) of MAHRA for cooperation among the PAE, project owner and mortgage servicer. The owner must actively work with the PAE and other necessary third parties, including the mortgage servicer, to develop a Restructuring Plan. If the owner fails to cooperate to the satisfaction of the PAE, and HUD agrees, the PAE will not continue with development of a Restructuring Plan.

Summary of Comments

One commenter asked HUD to clarify that an owner who is viewed as insufficiently ''cooperative'' in helping a PAE develop a restructuring plan that differs from the approach suggested by the owner will not become ineligible under § 402.7 for section 8 contract renewal without restructuring. Another commenter said that HUD should make it easier for servicers to ''cooperate'' with respect to first mortgages that are too small (before or after a partial claim) to attract servicers. This commenter mentioned such matters as difficulty in getting the consent of securitizers (including Ginnie Mae) or whole-loan investors, a need for an increased FHA servicing fee, reducing the costs of servicing (specifically, not requiring a mortgagee inspection if the PAE inspects), allowing financing costs to include reasonable administrative fees, considering an additional escrow account for servicing fees, and considering rebate of part of FHA premium such as the section 221(g)(4) put for Interest Enhancement Payment.

HUD Response: We will address the comment on eligibiity under § 402.7 when part 402 is published in final form. Inability of a mortgagee or servicer to obtain investor consent to modify, or their determination that the size of the restructured loan was not financially feasible to originate and/or service, is not considered a lack of cooperation for purposes of § 401.402. As noted in section III of this preamble under § 401.550, the final rule clarifies that HUD will accept an inspection by a PAE in lieu of an inspection by the mortgagee or servicer.

F. Sections 401.405–.406, Restructuring Commitment

Summary of Sections

These sections provide for HUD to approve a Restructuring Plan as submitted by a PAE, require changes as a condition for approval, or reject the Plan. HUD will inform the PAE of the reasons for rejection and the subpart F dispute and appeal procedure will apply. The PAE will deliver to the owner, for execution, a proposed Restructuring Commitment as the final element of a HUD-approved Restructuring Plan.

Summary of Comments

Two commenters said that HUD should be required to approve/disapprove a proposed Restructuring Commitment within a specified period after PAE submission; one of them suggested 10 days.

HUD response: OMHAR anticipates a standard processing time of 15 days for review of conforming transactions. Conforming transactions are those in which there is limited financial impact or risk to the Federal Government. Specific criteria will be defined in the Operating Procedures Guide and the PRA. The standard processing time for review of non-conforming transactions is anticipated to be 30 days.

G. Section 401.408, Affordability and Use Restrictions Required

Summary of Section

Section 401.408 of the interim rule implements section 514(e)(6) of MAHRA, which requires the Restructuring Plan to provide for affordability and use restrictions on the project for a term of at least 30 years, consistent with the long-term physical and financial viability and character of the project as affordable housing. During a period when at least 20 percent of the units in a project receive project-based assistance, this section provides that the affordability restrictions applicable to such assistance will apply in lieu of other restrictions required to be in the recorded Use Agreement. Otherwise, the Use Agreement will require conformance to the rent and tenant income profile used in the Low Income Housing Tax Credit Program (LIHTC) for any project that is restructured (*i.e.,* either rents set for 20 percent of the units at 30 percent of 50 percent of median income or for 40 percent of the units at 30 percent of 60 percent of median income.) The Use Agreement will specify which interested parties, in addition to HUD and the PAE, will have rights of enforcement.

Summary of Comments

1. Use restrictions and partially-assisted projects.

Two commenters expressed concern that § 401.408 makes use restrictions applicable to an entire project even when that project is only partially-assisted. Both commenters suggested that use restriction agreements should apply only to formerly-assisted units within a partially-assisted project. One commenter thought that a failure to make this exception would cause owners of partially-assisted projects to opt out of the section 8 program, which in turn would decrease the stock of affordable housing.

HUD response: HUD does not share the concerns of these commenters. Use restrictions run with the land because the entire project benefits from a debt restructuring. To the extent owners can opt out from further project-based assistance, they do not need the restructuring (and would not be subject to the Use Agreement).

2. Use Agreements should last ''exactly'' 30 years—not ''at least'' 30 years.

Four commenters were concerned about the requirement that the Use Agreement be in effect for ''at least'' 30 years. These commenters recommended that the final rule require the Use Agreement to be in effect for ''exactly'' 30 years because the interim rule language might allow PAEs to specify terms greater than 30 years indiscriminately. One commenter thought all Use Agreements should last for 30 years except where unusual conditions specified in the Operating Procedures Guide are present and the PAE decides that a longer term is consistent with statutory intent. Another commenter felt that a PAE's discretion to use terms longer than 30 years should be tightly overseen by HUD.

HUD response: MAHRA requires a Use Agreement term of at least 30 years. The decision to require a longer term should be left to the PAE as the party most familiar with particular circumstances that may make longer restriction periods appropriate.

3. If no section 8 funds are available, owners should be required to charge restructured rents or below-market LIHTC rents.

Two commenters felt that owners should be required to charge the lesser of restructured rents or Low Income Housing Tax Credit (LIHTC) rents (which may be below-market) in the event that section 8 funds are not available in the future.

HUD response: The owners of properties subject to Use Agreements will be limited to rents at the lesser of market or below-market LIHTC rents in the event that section 8 funds are not available in the future. Since market conditions will more likely improve or worsen rather than stay static, the market rents the units will command at that time will probably not be the restructured rents.

4. There should be no below-market level rents.

One commenter felt that the rule contemplated establishing below-market rents when fewer than 20 percent of the units in a project receive project-based assistance. This commenter was concerned about adverse tax consequences and strongly recommended that no project be required to reduce its rents below market level. Another commenter felt the final rule should indicate that owners will not be required to accept project-based or tenant-based assistance if the final rule does not allow for payment to the owner of market rents. This commenter also argued that, because LIHTC restrictions are not imposed by MAHRA, imposing such restrictions could cause owners to evict tenants with higher incomes or hold units vacant for unreasonable time periods. The commenter suggested less restrictive affordability requirements. If LIHTC requirements are maintained, this commenter felt that owners should have the choice of affordability mix options.

HUD response: When fewer than 20 percent of the units in a project receive project-based assistance, the Use Agreement will have the practical effect of requiring the lesser of market rents (as a result of the operation of the local rental market) or the LIHTC rents (as specified in the Use Agreement). Further, the owner has the option of selecting the tax credit standard (20 percent of the units with rents affordable at 50 percent of median income, or 40 percent of the units with rents affordable at 60 percent of median income) which yields the highest net operating income. For the inventory of projects with above-market section 8 rents, the LIHTC rents are often greater than market rents. In cases where the LIHTC rents are less than market rents, the impact on the supportable secured debt (and thus the tax consequences of the restructuring) will typically be nominal. A less restrictive affordability requirement is not appropriate.

5. Enforceability of Use Agreements and notice.

Two commenters felt that tenants and tenant organizers should always be given the right to enforce Use Agreements, which the interim rule did not seem to demand. Another commenter felt that third parties should not be allowed to challenge matters that both the PAE and the owner agree upon, or without prior written permission from the PAE. This commenter also felt that the rule should make clear that the owner should receive notice of any enforcement actions as well as a reasonable opportunity to cure any problems. One commenter felt that the right of parties to enforce a Use Agreement should be tightly controlled. One commenter felt that HUD should identify the specific remedies provided each party that may enforce a Use Agreement. This commenter also felt that HUD should, at a minimum, indicate that all enforcement actions must be initiated by HUD/PAE and that HUD/PAE will have sole responsibility for determining what steps an owner must take to cure any violations.

HUD response: Section 401.408(i) of the final rule makes it clear that Use Agreements will include the parties listed in that paragraph as third party beneficiaries. Further, a Use Agreement must require the party bringing enforcement action to give the owner notice and a reasonable opportunity to cure any violations. The PAE or HUD will typically be the entity bringing enforcement action, but this provision has been specifically crafted to allow other parties to bring action. This will ensure that other interested parties such as tenants are able to protect their interests in cases where a project is not covered by a PRA, or where HUD or the PAE is unable or unwilling to take action. In the rare case where HUD perceives clear abuse by a third party that is not exercising enforcement rights in good faith, HUD may exercise its right to modify a Use Agreement to require the third party to obtain prior HUD approval for any enforcement action concerning the Use Agreement.

6. Pre-existing Use Agreements should be preserved.

Two commenters suggested that a Mark-to-Market Use Agreement should be subject to any pre-existing Use Agreements, which should be preserved. One of these commenters felt that the final rule should make clear that the restructuring process should not be used to lessen any previous affordability restrictions.

HUD response: Restructuring under the Mark-to-Market Program will not automatically relieve a project of any existing Use Agreements and affordability restrictions. If an owner considers that existing agreements and affordability restrictions are based on section 8 terms and policies no longer authorized by Congress, or will interfere

with achieving the objectives of a proposed Restructuring Plan, the owner should bring this concern to the PAE's attention so that the PAE can consider proposing appropriate changes for HUD's approval.

7. Use Agreement should be subordinate to conventional loan.

One commenter felt that if the restructured first loan is refinanced with a conventional loan, then the Use Agreement should be subordinate to this loan (*i.e.* the Use Agreement should not survive foreclosure). This commenter argued that most conventional lenders will refuse to refinance mortgages subject to Use Agreements if the agreements survive foreclosure.

HUD response: Section 514(e)(6) of MAHRA requires a Use Agreement to apply for at least 30 years and any subordination that could lead to termination of the Use Agreement upon foreclosure of a conventional loan would conflict with this MAHRA requirement.

8. Renewal contract terms must remain materially the same.

Five commenters said that renewals of project-based contracts should be required to contain terms that are materially similar to the initial post-restructuring contract. Two commenters argued that unless this is done, general partners will have difficulty recommending the restructuring transaction to limited partner investors. One commenter suggested that the final rule make it ''crystal clear that HUD cannot decrease the benefits to the owner upon subsequent renewal offers.'' Another commenter felt that Use Agreements should contain conditions for automatic expiration of the agreement should there be changes to the agreement that are detrimental to the original terms and conditions of the restructuring plan. One commenter felt that an owner's obligation to renew section 8 assistance should terminate if HUD/PAE fails to renew for any year. The same commenter felt that under the final rule there should be no circumstances, other than unavailability of funds or HQS violations by the owner, under which HUD/PAE may refuse to renew project-based section 8 assistance. Another commenter felt that HUD should guarantee that section 8 funds would be available in the future as long as necessary to assure affordability. This commenter felt that imposing use restrictions would be meaningless without a guarantee of section 8 funds for the project.

HUD response: Under section 515(a) of MAHRA, either the Secretary or a PAE acting under a contract with the Secretary is required to offer to renew or extend an expiring contract, subject to the availability of amounts provided in advance in appropriations Acts. In addition, Pub. L. 106–74 amended section 524 of MAHRA (which applies to contract renewals after a Restructuring Plan is in place) to make renewals mandatory upon owner request, also subject to appropriations. MAHRA does not expressly require that the offer be in accord with the contract renewal terms provided in the approved Restructuring Plan and implies that the level of appropriations may not always permit such an offer to be made. There is no guarantee of, and the Department does not have the authority to obligate, section 8 funds unless Congress appropriates the funds. Section 515(a) protects the owner by only requiring the owner to accept the renewal offer if the offer in ''in accordance with the terms and conditions specified in'' the Restructuring Plan. If the section 8 contract terms are offered under terms less favorable than those which would result by application of the OCAF as provided in the Restructuring Plan (to the extent, if any, permitted by MAHRA section 524), the owner will not be required to accept the renewal offer, but the project will remain subject to the Use Agreement for the remainder of its term.

H. Sections 401.410–.412, Determining and Adjusting Rents Under Restructuring With Project-Based Assistance

Summary of Sections

Section 401.410 provides guidance to the PAE for determining comparable market rents, as well as for an owner making a preliminary determination of eligibility under § 401.99(a)(1). Comparable market rents are rents charged for ''comparable properties'' as defined in section 512(1) of MAHRA. The determination of whether rents in a project are comparable to market rents considers only the rents for units in the project that receive project-based assistance.

Section 401.411 provides for budget-based ''exception rents'' (not to exceed 120 percent of Fair Market Rent without a HUD waiver), instead of comparable market rents, if the PAE determines that the housing needs of the tenants and the community cannot be adequately addressed through a Restructuring Plan that provides for comparable market rents, and if the project would be a negative Net Operating Income (NOI) project at comparable market rents. The preamble to the interim rule—but not the rule itself—stated that in order to receive exception rents, projects must meet the following test (which we will call the ''positive social assets'' test in the following discussion):

> [The projects] must be determined by the PAE to be positive social assets in the community whose operating expense levels and lack of debt service capacity are not a function of bad management. They should be unique, appropriately situated, and affordable housing, with no other comparable housing alternatives available in the submarket.

Exception rents are based on the factors listed in section 514(g)(3) of MAHRA. They include debt service (allowed in the interim rule only on the second mortgage under § 401.461 or to support a rehabilitation loan included in the Restructuring Plan), project operating expenses, a PAE-determined allowance for a reasonable rate of return to the owner, contributions to adequate reserves, and other necessary project operating expenses as determined by the PAE.

Section 401.412 concerns adjustment of restructured rents by an operating cost adjustment factor (OCAF) as required by section 514(e)(2) of MAHRA. A Restructuring Plan will provide for adjustments using OCAF under this section, but this section will not prevent HUD from offering renewal with rent levels higher than those resulting from OCAF adjustments, if legally authorized.

Summary of Comments

1. Difficulties in determining comparable market rents.

One commenter noted that there are unlikely to be comparable unassisted projects in low-income areas. Another noted that, for projects with special needs populations (elderly, disabled), comparisons must take special features and services into account.

HUD response: HUD agrees that determining comparable market rents will be problematic in some cases. Section 401.410 (both the final rule text and the interim rule preamble explanation) address this issue with a methodology consistent with express Congressional intent that assisted projects not be used for rent comparables.

2. ''Blended'' rents considering unassisted but restricted units.

Three commenters wanted the final rule to clarify the treatment of projects for which unassisted units with long-term affordability restrictions (such as in ELIHPA/LIHPRHA preservation projects) considered together with assisted units with above-market rents would result in a ''blended'' average rent not exceeding market comparable rents. The commenters argued that such

projects should qualify as projects with rents not exceeding market comparable rents and, therefore, should be eligible for contract renewal as exception projects under § 402.5(a)(2). This could enable the projects to achieve sufficient net operating income to achieve owner returns anticipated in preservation program Plans of Action.

HUD response: HUD will only consider units assisted under the expiring section 8 contract in determining whether the aggregate rents are higher or lower than market. Preservation projects with approved plans of action under ELIHPA or LIHPHRA are no longer eligible for the Mark-to-Market program. Please see the related response under Section II.A.3.b. of this preamble.

3. Objections to ''negative NOI project'' and ''positive social asset'' requirements for exception rents.

Many commenters objected to either § 401.411 concerning when to use exception rents, or to preamble discussion supplementing that section regarding negative NOI projects and the ''positive social assets'' test. One commenter objected to the limitation of exception rents to negative NOI projects, stating that Congress included exception rents for cases such as rural projects and inner cities or special populations needing budget-based rents and that requiring no debt service would make the ''rate of return'' factor in section 514(g)(3) of MAHRA a ''nullity''. One commenter stated that exception rents must have a second mortgage debt service component adequate to support ''reasonable likelihood of repayment'' requirement to avoid adverse tax consequences to the project owner, while another suggested that all LIHPRHA projects with Plans of Action should be treated as exception rent projects, even without negative NOI, if the statutory test is met.

Eleven commenters objected to the positive social asset test in its entirety on grounds that it is unnecessary and not provided for in MAHRA. Two of these commenters also objected specifically to the statement that exception rents should not derive from bad management. Another commenter who objected to the positive social asset test said that, if it were to be included, there must be clear guidance and objective standards in the Operating Procedures Guide on how it would be applied. Another objected to routine application of the test but felt it could be appropriate for a determination about waiving the 120 percent limit.

HUD response: HUD gave particular consideration to this issue in light of the volume of comments received from a broad spectrum of interest groups, and convened a focus group on November 18, 1998, in part to discuss the matter. We are concerned that there appears to have been widespread confusion regarding HUD's intent in including the ''positive social assets'' test in the interim rule preamble. By including the language in the preamble, and not in the rule itself, HUD tried to provide additional help to the PAEs that must apply the actual statutory test for exception rents (which also appears in the rule itself): that ''the housing needs of the tenants and the community cannot be adequately addressed'' through comparable market rents. In other words, if housing needs can be adequately addressed through a Restructuring Plan with comparable market rents, the PAE may not consider exception rents.

But equally important, exception rents also cannot be approved if a Restructuring Plan with exception rents would not adequately address tenant and community housing needs. The statute demands more than simply a negative test regarding use of comparable market rents: the PAE must be convinced that (rent issues aside) the project is worthy of restructuring in lieu of some other approach to meeting tenant and community needs. As we attempted to suggest in the interim rule preamble, this necessarily requires that a project have certain positive attributes that justify continued approval of rents that exceed the market. Since many commenters viewed the interim rule preamble as an attempt to graft onto MAHRA new considerations that were foreign to the statutory provisions, we consider it advisable not to repeat the ''positive social assets'' test as stated in that preamble. PAEs must, however, be aware of the need for meeting all aspects of the statutory objective that we have discussed above.

In particular, PAEs must recognize that exception rents should never be approved if the project would otherwise be rejected for restructuring under section 516 of MAHRA because of serious ownership or physical condition problems that cannot be remedied. A PAE's recommendation of exception rents for a project presumes that, at a minimum, the project and owner have been determined and confirmed eligible for restructuring as required by § 401.403. Thus, exception rents should not be approved for projects that are determined by the PAE to have an irreversible detrimental impact in the community, for reasons such as unacceptable management practices that adversely impact the community, or are deemed ineligible for a mortgage restructuring due to the poor condition of the project. In order to receive exception rents, the PAE must make a determination that the housing needs of the tenants and the community cannot otherwise be adequately addressed. In making this determination, the PAE should ensure there are inadequate comparable housing alternatives available in the sub-market, so that the outcome without project restructuring at exception rents would be displacement of those tenants who would experience difficulty in finding comparable housing, such as the elderly, persons with disabilities, and large families.

We agree that rural and inner city projects in certain jurisdictions will be more likely to need above-market exception rents, due to typically low market rents relative to operating expenses. The rule makes provision for PAEs to request a waiver (based on special need) of the limitations on the number of units that can receive such rents. Restricting exception rents to projects with negative NOI, or rehabilitation needs in excess of that which can be supported by new financing at market rents, is consistent with MAHRA.

The final rule provides for exception rents adequate to pay debt service on the second mortgage and the other items detailed in section 514(g)(3) of MAHRA. Because of a recent amendment to MAHRA in Pub. L. 106–74 that authorizes full payment of claims, there is no longer any need for a Restructuring Plan to provide for any nominal restructured first mortgages. Also, see Section II.K.6. of this preamble for a separate discussion of how return to owner is considered in determining exception rents. The Operating Procedures Guide specifies that the rents should be set to estimate the owner return that would be realized if there were a positive but nominal NOI, and to make payments on the new second mortgage. The second mortgage will be sized based on the amount that can reasonably be expected to be amortized by 75 percent of the anticipated net cash flow (*i.e.,* three times the owner's estimated return). A third mortgage may be required to the extent the claim paid by HUD under § 401.471 exceeds the amount of the second mortgage.

4. Exception rents should be alternative to FMR.

One commenter said that the rule should let a PAE choose exception rents under § 401.411 instead of using 90 percent of fair market rents (FMRs), which the rule identifies as a last resort under § 401.411(d). The commenter felt that FMRs are often not useful.

HUD response: To the extent the PAE is unable to develop a comparable rent using the methodology outlined in § 401.410, 90 percent FMR may be used (as a last resort) as a proxy for comparable rent as provided by statute. Exception rents for projects undergoing Mark-to-Market restructuring are limited by statute to cases where the comparable rent (or 90 percent FMR) is inadequate to meet expenses with no debt service or where the supportable debt is insufficient to fund short term rehabilitation needs.

5. Limitation of exception rents to 120 percent of FMR.

A commenter characterized this 120 percent limit as ''arbitrary'' and said that ''waivers may become the rule''.

HUD response: This limit is specified by section 514(g)(2)(A) of MAHRA.

6. Need to define ''community''.

One commenter focused on the definition of the ''community'' impacted by a failure to allow exception rents, and urged HUD to consider supply of affordable housing in an entire jurisdiction, not just a neighborhood.

HUD response: HUD will rely on the PAE's judgment to make this determination.

7. Other factors to be included in expenses.

Commenters had suggestions for expenses to consider when determining the budget-based exception rents. In addition to the comments noted above regarding mortgage debt and return to owners, two commenters stated that the return to an owner anticipated in a LIHPRHA Plan of Action should be factored into exception rents, and one commenter suggested expenses should include health and social services for elderly/handicapped projects.

HUD response: Project operating expenses may include social services (such as for elderly/handicapped service coordinators, or other Departmental initiatives such as Neighborhood Networks) to the extent they have been approved by the Department, and/or have been determined by the PAE to be efficiently managed and unique and necessary for the project's continued operation as an affordable housing resource. LIHPRHA projects with approved plans of action are no longer eligible for the Mark-to-Market Program.

8. Determination of OCAF.

a. General. Three commenters said that HUD should base OCAF on inflation indicators published outside of HUD; while another commenter ''applauded'' HUD for restricting increases to documented operating cost increases. Two others noticed that the geographical area considered when determining OCAF is left undefined in the rule. They remarked that it should not be too large to pick up local fluctuations in taxes, utilities, *etc.*

HUD response: A HUD analysis of operating cost data for FHA-insured projects showed that their expenses could be grouped into nine categories—wages, employee benefits, property taxes, insurance, supplies and equipment, fuel oil, electricity, natural gas, water and sewer. States are the lowest level of geographical aggregation at which there are enough projects to permit statistical analysis. Operating expense-related data on a more localized basis are not available on a current or consistent basis. HUD's OCAF calculations use data series prepared by the U.S. Bureau of Labor Statistics, the Bureau of the Census, and the Department of Energy. Owners may apply for a budget-based rent review in the presumably unusual case that application of the OCAF does not address unexpected project specific fluctuations. We expect, however, that such fluctuations and other temporary constraints on net operating income will be covered by excess debt service coverage.

b. Excluding debt service. Two commenters objected to excluding debt service from the expenses to be adjusted by OCAF. One said the exclusion will make projects increasingly vulnerable to periods of low occupancy and less likely to support a second mortgage, requiring some other means to boost rents; another said the exclusion will decrease attractiveness of the project to investors who want increase over time in debt service coverage.

HUD response: Congress' use of the term ''Operating Cost Adjustment Factor'' (OCAF), which has historically been applied only to operating expenses, rather than the term ''Annual Adjustment Factor'' (AAF) suggests that Congress expected the Department to not apply the increase to the entire rent. Debt service payments remain constant, so it is not appropriate to apply an inflation factor to the debt service. The debt service component of the effective gross income is the only portion that will not be inflated by the OCAF; the Reserve for Replacement deposits and the portion of the debt service coverage estimates for owner return will increase and presumably remain constant with inflation.

9. Negative OCAF.

Three other commenters objected to the reduction of rents by using negative OCAF. Two of them questioned the legality of rent reductions in light of section 8(c)(2) of the United States Housing Act of 1937.

HUD response: We have removed the reference to negative OCAF in response to section 531(a) of Pub. L. 106–74.

10. Appeals of OCAF.

One commenter wanted an owner right to appeal OCAF determinations.

HUD response: OCAF is not determined on a case-by-case basis and adjustment of OCAF through appeal for a particular project is not appropriate. However, the commenter probably was interested in the ability to appeal the rent adjustment that resulted from use of OCAF. OCAF is used for rent adjustments for projects with and without Restructuring Plans, but HUD retains the discretion to use a budget-based rent adjustment instead at the request of the owner. The statutory reference to using OCAF in Restructuring Plans, and the corresponding regulatory provision in § 401.412, does not preclude HUD from approving a larger budget-based increase when appropriate even though a project is under a Restructuring Plan.

An owner may request a budget-based rent adjustment if the owner can demonstrate that available operating revenues are insufficient to maintain a project. The published OCAF factors are based on independently produced estimates of changes in major costs items, and should prove adequate in most projects. If rent adjustments through use of OCAF are inadequate, however, budget-based review provides the most relevant basis for reviewing the adequacy of overall project funding.

I. Sections 401.420–.421, Project-Based Assistance or Tenant-Based Assistance?

Summary of Sections

These sections implement section 515(c) of MAHRA, which: (1) Provides for mandatory renewal of project-based assistance in a Restructuring Plan for projects in tight rental markets and elderly or cooperative housing projects; and (2) requires the PAE to develop a Rental Assistance Assessment Plan for any other project to determine whether assistance should be renewed as project-based assistance or whether some or all of the assisted units should be converted to tenant-based assistance. The Plan is developed by assessing the impact on eight specific areas described in section 515(c)(2)(B) of MAHRA. Section 515(c)(2)(C) of MAHRA requires periodic reporting by the PAE to HUD on certain matters concerning the form of assistance; this requirement is also included in the rule.

Summary of Comments

1. What vacancies should be considered in determining the presence of a tight market?

Six commenters objected to a PAE considering all kinds of vacant units when determining the presence of a tight market. These commenters felt that a PAE should consider only vacancies in comparable units in standard condition (neither luxury nor substandard) with rents not exceeding the payment standard for tenant-based assistance. Four commenters objected to considering vacant units in the entire market only and indicated that a PAE should determine whether the vacancy rate in the sub-market or neighborhood is at or below six percent. Another commenter said that in determining whether a project was predominantly elderly, individual phases should be considered if the project was developed in phases.

HUD response: Consistent with Congressional intent, as indicated in the Conference Report accompanying MAHRA, the tight market ''safe harbor'' for project-based assistance will be applied to metropolitan areas with vacancy rates less than or equal to 6 percent. HUD agrees that comparable units in the relevant affordable housing sub-market should be considered by the PAE in the context of the Rental Assistance Assessment Plan developed under § 401.421. The PAE has flexibility in this decision on a project-by-project basis, and is expected to apply its knowledge of the local market and use its judgment in recommending the type of rental assistance.

2. Effect of sale to cooperative.

One commenter inquired whether project-based assistance was mandated if a sale of the project to a cooperative is planned.

HUD response: Yes, project-based assistance is mandated if the project is sold to a ''nonprofit cooperative ownership housing corporation or nonprofit cooperative housing trust'' (pursuant to section 515(c)(1)(C) of MAHRA, referenced in § 401.420(a)).

3. Limit conversion approvals to public body PAEs.

A commenter suggested that only PAEs that are public bodies should be able to approve Restructuring Plans with conversion to tenant-based assistance.

HUD response: All PAEs are permitted to develop Restructuring Plans with conversion, if conversion is consistent with the final rule. OMHAR will be required to approve all Restructuring Plans, including the type of rental assistance, regardless of the category of PAE. Particular attention will be paid during review of project specific transaction, and through the reporting requirements of § 401.421(d), to projects converting to tenant-based assistance and projects that retain project-based assistance despite the general support by the tenants to convert to tenant-based assistance. Under § 401.200 of the final rule, non-public PAEs will be required to form a partnership relationship with HUD if no other public entity is involved. (Note that the final rule omits the requirement in interim rule § 401.200 that the partnership relationship meet all legal requirements for a partnership.)

4. Requirement for semi-annual reporting in § 401.421(d).

One commenter objected to what the commenter saw as a requirement for ''continuous'' reporting rather than ''one-time''. Another asked how much data gathering/tracking of tenants is required by the PAE, and at what cost?

HUD response: The reporting requirement is for semi-annual reports and is not continuous. The amount of data gathered by the PAE from the tenants will be detailed in the Operating Procedures Guide. Reimbursement of costs for gathering such information from tenants will be addressed in the PRA.

5. How should the final rule handle/present factors to be considered in the Rental Assistance Assessment Plan?

Four commenters wanted HUD to clarify the weighting of the statutory factors and to give more guidance to the PAEs. Three commenters said that all statutory factors should be set forth in full in the final rule, instead of only stating the factor regarding cost comparison. Two commenters felt that the rule should state a presumption in favor of project-based assistance in order to recognize the cost to tenants of conversion. One commenter indicated that the factor regarding ability of tenants to find housing in the local market should focus on the ability to use tenant-based assistance effectively in the neighborhood. One commenter felt that HUD should specify the criteria that will be applied to determine whether a project will receive project or tenant-based assistance. One commenter suggested that conversion to tenant-based assistance should be approved only if rehabilitation needs are so extreme that restructuring is not feasible.

HUD response: The statute and regulations are both neutral with regard to the type of assistance to be provided, assuming the project does not meet the criteria of section 515(c)(1) of MAHRA. The interim rule's specific mention of the comparative cost of project-based versus tenant-based assistance as one of the required considerations was not an indication that this criterion should be weighed more heavily than the other items detailed in section 515(c)(2)(B) of MAHRA. Consistent with the Conference Report for MAHRA, the PAE should apply its knowledge of the local market conditions, and consider the various factors, with no one factor weighted more heavily than others except to the extent appropriate on a project-by-project basis. We agree with the commenters that there may be a benefit from full presentation of the statutory items to be considered in a Rental Assistance Assessment Plan, and we have made this change in the final rule. (See Section II.W.5. of this preamble for a general discussion of including statutory language in the final rule.)

6. Must all units be assisted under a Restructuring Plan?

One commenter said the interim rule was ambiguous on whether a Restructuring Plan must commit an owner to putting 100 percent of the units in a project under project-based or tenant-based assistance, and suggested that 20 percent of the units could be reserved for unassisted ''market rate'' tenants.

HUD response: Tenants residing in all previously-assisted units will have the opportunity to receive either tenant-based or project-based assistance. Unassisted market rate tenants may be served to the extent a project converts to tenant-based assistance and tenants move out, subject to (1) the Use Agreement requirements that the minimum number of units be reserved to meet low income housing tax credit rent and income requirements and (2) the prohibition in § 401.556 of the final rule (§ 401.483 of the interim rule) against refusal to lease units to prospective tenants solely on the basis of their status as section 8 voucher holders.

J. Sections 401.450–401.453, Physical Condition of Project

Summary of Sections

The Restructuring Plan must provide for rehabilitation of the project necessary to achieve the property standards set forth in § 401.452. (In this preamble and in the final rule itself, the term ''rehabilitation'' is being used in a broad sense—comparable to the broad use of the term in section 531 of MAHRA—that includes nonrecurring maintenance (repairs) and payment into project replacement reserves.) The first step is an owner evaluation of the physical condition and rehabilitation needs of the project (including consideration of appropriate measures to ensure accessibility). The PAE is then responsible for an independent

evaluation of the rehabilitation needs (a Physical Condition Analysis, or PCA) of the project, and for reviewing and certifying to the accuracy of the owner's evaluation (which may be modified to address deficiencies identified by the PAE.) Based on the completed PCA, the PAE must consider rejecting a request for a Restructuring Plan if the PAE cannot determine that proceeding with restructuring involving rehabilitation is more cost-effective in terms of Federal resources than rejecting the request and providing tenant-based assistance for displaced tenants. Any such consideration must be made in light of the need to minimize displacement of tenants and to ensure that there are alternative housing options available in the community.

As provided in section 517(b)(7)(A) of MAHRA and § 401.452, the standard for rehabilitation to be performed upon approval of restructuring is a non-luxury standard adequate for the rental market intended at the original approval of the project-based assistance. The physical needs identified should be those necessary for the project to retain its original market position as an affordable project in decent, safe and sanitary condition (including those improvements the project requires to achieve any rentals in the non-subsidized market), resulting in a marketable project that competes on rent rather than on amenities and that meets accessibility requirements. Over the long term, the owner must maintain the project in a decent, safe, and sanitary condition based on the housing quality standards identified in § 401.558 of the final rule (§ 401.453(a) of the interim rule). For a project receiving project-based assistance, the applicable standards will be HUD's Uniform Physical Condition Standards. Otherwise, local codes will serve as the standards as long as local codes are as strict as HUD standards and do not severely restrict housing choice in the view of the PAE. In addition, any unit in which the tenant receives tenant-based assistance must comply with the housing quality standards of the section 8 tenant-based programs.

Summary of Comments

1. Use of FNMA PNA guidelines should not be eliminated.

One commenter strongly believed that the elimination of an assessment presentation format for the owner under § 401.450 would lead to unnecessary and costly disputes in processing transactions. This commenter's experience in the demonstration program led the commenter to conclude that failure to prescribe an assessment presentation format would cause a high probability of frequent disputes that focus on presentation issues rather than substantive issues.

HUD response: Based on our experience in the demonstration program, we do not believe the format of an owner's assessment of the physical condition of the property will result in delays or disputes. The information specified in Section 401.450 must be presented in a form acceptable to the PAE. The owner may update and submit previously-prepared physical inspections. The PAE is required to independently evaluate the condition of the property. The Operating Procedures Guide contains more specific information.

2. The final rule should make clear that third-party expenses for physical condition evaluation are eligible project expenses.

Two commenters suggested that the final rule should make clear that third-party expenses for the owner's physical condition evaluation are eligible project expenses. One of these commenters pointed out that a customary fee for a physical condition evaluation is in the $5,000 range.

HUD response: Third party expenses for physical condition assessments are eligible project expenses if cash flow is sufficient to support such an expense. If cash flow is not sufficient, the expense is not an eligible project expense and will not accrue or carry over.

3. Lead hazards.

One commenter felt that the final rule should explicitly require a lead hazards analysis as part of the physical conditions evaluation.

HUD response: Inspection for lead-based paint will be part of both the owner's evaluation and the PAE's PCA. This requirement is set out more fully in the Operating Procedures Guide. If such paint is found in a family project in a peeling condition on chewable surfaces, it must be remedied. If found, but not posing immediate risk, the owner will be required to submit a ''Maintenance Plan'' to prepare for any future risks/remediation. Effective September 15, 2000, all projects with section 8 project-based assistance will be subject to HUD's revised lead-based paint regulations published on September 15, 1999 (64 FR 50140).

4. Reserve account deposit.

One commenter felt that owners should be permitted to assume that their section 8 contract will be renewed for 20 years when calculating the amount of deposit to the reserve account.

HUD response: No assumptions should, or need to, be made regarding the continued availability of section 8 assistance in determining the reserve for replacement accounts. The regulatory agreement will be modified to require the monthly deposit requirement to be adjusted annually by the OCAF.

5. Concern about cost-effectiveness determination in § 401.451(c).

Numerous commenters were concerned about the cost-effectiveness determination required by § 401.451(c). Six commenters were concerned that the cost-effectiveness determination was not consistent with statutory intent. Three of these commenters asserted that it was Congress' intent that all properties that met statutory criteria and whose owners were willing to restructure should be restructured, and expressed concern that the interim rule placed cost-effectiveness above all other considerations. At least five commenters said that § 401.451(c) should be removed from the rule.

One commenter felt that the standards and methodologies used to disqualify a project based on cost-effectiveness should be published for public comment. Another commenter felt that the rule was ambiguous and that, without clearly articulated standards in the Operating Procedures Guide, PAEs would be faced with a difficult decision regarding what represented cost-effective use of Federal resources. Another commenter stated that the cost-effectiveness determination needed to be guided by an objective standard. One commenter suggested that the PAE should be given other factors to consider before concluding that a project was cost prohibitive, and that there should be a clear presumption in favor of preserving the housing stock and maintaining the project-based rental assistance. Another commenter felt that ''non-economic objectives should take precedence'' as long as a project met tenant and community housing needs. Another commenter felt that the rule must make clear that the impact on tenants and the community is an integral part of the cost-effectiveness determination and not ''some minor, peripheral consideration.''

HUD response: HUD discussed implementation of the ''cost-effectiveness'' test with a broad variety of interest groups at the focus group meeting on November 18, 1998. While PAEs are required to ensure that all repair items are cost-effective, the determination required by this section is intended to ensure particular scrutiny by the PAE of those projects that have significant rehabilitation needs so that other less costly approaches (either in the scope of work or by recommending rejection of the Restructuring Plan) are considered. We expect the PAE to

exercise judgment in balancing the competing economic and social objectives in every case rather than relying on an ''objective'' standard set by HUD.

6. PAE certification.

One commenter felt that it would not be possible for a PAE to certify the accuracy and completeness of an owner's evaluation of a project's physical condition. The commenter was concerned that requiring a PAE to certify the owner's evaluation would put the PAE in an untenable position because physical condition assessment is often complex and ''ultimately not empirical.'' The commenter suggested that the PAE merely ''confirm that the owner's plan reasonably reflects their own findings and they believe the needs are addressed cost-effectively.''

HUD response: The rule and MAHRA both require a PAE to certify an owner's evaluation of project physical condition. The PAE should give the owner the opportunity to revise the owner's evaluation after consultation regarding any disputed work items or costs. Alternatively, the PAE must recommend rejecting the Restructuring Plan. OMHAR will be responsive to PAE questions concerning rehabilitation standards; however, it is a PAE's responsibility to bring its professional judgment to bear as it evaluates the owner's proposal, the PAE's independent third party report, and tenant and local community input when developing the Restructuring Plan.

7. Property standards for rehabilitation.

One commenter felt that ''lowering the bar to modest competition'' by effectively accepting diminished physical conditions would have a negative impact on quality-of-life and public relations because eligible projects—while not luxurious—may compare favorably to other conventional properties in the area. Another commenter suggested that this ''non-luxury'' standard be removed from the final rule because it is not effective guidance (amenities affect rent and vice versa and what is an amenity in one market is a marketing necessity in another) and the standard would be cited to discourage rehabilitation to a level that might attract a mixed-income occupancy. Another commenter felt that the standard might not be consistent with the legislative goal of assuring that projects be able to function in the marketplace without assistance.

One commenter felt that calling for the ''least costly rehabilitation plan'' may cause owners to purposefully underestimate their physical condition assessments in order to avoid disqualification. This commenter suggested that rehabilitation standards should be based on actual need determined with tenant assistance. One commenter suggested that the final rule reference the physical condition standards prescribed in § 401.453 of the interim rule if a project's Restructuring Plan is to provide for continued project-based assistance. The commenter recommended that rehabilitation for these projects should be sufficient to meet the Uniform Physical Conditions Standards in 24 CFR § 5.703. One commenter felt that a lender who refinanced the first mortgage a conventional loan should be able to require whatever rehabilitation the lender considers appropriate. In addition, this commenter felt that HUD should indicate whether rehabilitation is supposed to address issues raised in the PCA or satisfy the physical conditions standards in § 401.453 of the interim rule.

HUD response: The final rule requires restoration suitable for the market for which the project was originally approved. Thus, materially diminished physical standards would not be acceptable as part of a Restructuring Plan. The PAE's inspector must ensure that the project meets the applicable physical condition standards, but immediate threats to health and safety are not eligible work items that may be deferred until completion of the Restructuring Plan. Rather, they must be corrected immediately and, since the existence of these matters violates the Regulatory Agreement, the PAE must evaluate the project's eligibility in accordance with § 401.403(b)(2)(ii). The repair work items should address the issues raised in the PCA. The rehabilitation standard requires a project that can compete in the marketplace. To the extent the market requires a particular amenity, it should be added to enable the project to compete on the basis of rent. We expect the PAE to exercise professional judgment and to apply their knowledge of local conditions in determining if the lack of an amenity would render a property unmarketable. The PAE is required to independently evaluate the physical condition of the project, including evaluating the accessiblity of the project to persons with disabilities, and to solicit tenant and local community comments. The PAE can recommend that OMHAR approve lender rehabilitation requirements so long as they are consistent with the requirements of the Restructuring Plan.

8. Physical condition standards should not apply to non-assisted market rent units.

One commenter argued that section 8 units (both project-based and tenant-based assistance) are already covered by physical condition standards by virtue of HAP contracts so that the only effect of § 401.453 of the interim rule would be to make the standards applicable to non-assisted market rent units. This commenter suggested that the final rule should provide that HQS will be applicable to assisted units in restructured properties through the terms of assistance contracts and that the local housing code should be the applicable standard for non-assisted units.

HUD response: Section 514(e)(5) of MAHRA does not permit non-assisted units to be excluded from the physical condition standards. This is a reasonable result because the entire project benefits from a mortgage restructuring. In keeping with 24 CFR parts 5.703 and related changes in other regulations, this rule recognizes that the separate section 8 HQS has been eliminated for projects with project-based assistance.

K. Sections 401.460–401.471, Mortgage Restructuring and Payment of Claims

Summary of Sections

Section 401.460 explains the standards for restructuring with a modified or refinanced first mortgage. The first mortgage will be a fully amortizing, level payment mortgage with a principal amount sustainable at rent levels that do not exceed the lower of section 8 rents allowed under the Mark-to-Market Program or rents permitted under the Use Agreement under § 401.408. The PAE should take into account any need for financing needed rehabilitation when sizing the first mortgage and determining the appropriate amount of mortgage insurance payment by HUD. The monthly payment for the first mortgage under the Mark-to-Market Program will not exceed the current first mortgage payment. Interest rates and other terms must be competitive in the market, with any fees and costs above normal processing fees to be paid by the owner from non-project sources. Due to the significant potential for conflicts of interest if the PAE provides the first mortgage financing, HUD will apply an exceptionally high level of review whenever this is proposed as part of the Restructuring Plan, with special HUD approval needed for any PAE risk-sharing under 24 CFR part 266 for a refinanced first mortgage. HUD will approve risk-sharing when appropriate in accordance with Pub. L. 106–74.

Section 401.461 provides standards for the new HUD-held second mortgage which is needed whenever the insured or HUD-held mortgage debt is written down through payment of a section 541(b) mortgage insurance payment by HUD. The second mortgage is limited to an amount that the PAE reasonably expects to be repaid by the owner, and may not exceed the difference between the first mortgage before restructuring and the modified or refinanced first mortgage after restructuring. HUD may require a HUD-held third mortgage if the amount of a partial claim under § 401.471 exceeds the principal amount of the second mortgage. The second mortgage will bear simple interest of at least 1 percent, but no more than the applicable Federal rate determined by the Department of the Treasury. The term will be concurrent with the term of the modified or refinanced first mortgage or, if the existing first mortgage is completely paid off, the term will be set by HUD. The mortgage will become due and payable as provided in § 401.461(b)(3). At least 75 percent of the project's net cash flow after payment of first mortgage debt service and operating expenses must be used to pay principal and interest on the second mortgage. The rest of the cash flow may be paid to an owner who meets certain property management and physical condition standards. HUD will consider modification or forgiveness of the second mortgage if: (1) The project has been sold or transferred to a priority purchaser under § 401.480; and (2) HUD determines that modification or forgiveness is necessary for recapitalization to preserve the project as affordable housing.

Summary of Comments

1. How should net operating income available to pay the first mortgage be determined?

a. Expenses. Commenters offered ideas about the expenses to be paid from operating income before determining ''net'' operating income for this section. One commenter listed a number of lender-required costs that should be allowed in the case of conventional refinancing. Three commenters felt that a reasonable rate of return to the owner needed to be considered; one of them said it should not be below the return already allowed. Three commenters said that the owner compensation provided under a plan of action for preservation projects needed to be considered.

HUD response: Reasonable expenses to meet requirements of the lender (whether the first mortgage is FHA-insured, HFA-originated with risk-sharing, or conventional debt) will be acceptable so long as the financing is competitive. See the discussion of return to owner at Section II.K.6. Preservation projects are no longer eligible for the Mark-to-Market Program.

b. Sizing the first mortgage. We received other comments relating to sizing the first mortgage. Two commenters objected to sizing on the basis of LIHTC rent levels if lower than comparable market rents. Two others wanted HUD to state a debt service coverage ratio (DSC) in the rule: One suggested 1.20, the other suggested at least 1.25 for conventional loans. Another said the DSC should be adequate to permit sale of the mortgage at or very near ''par''. A commenter said that a restructuring plan for a project with an existing insured second should write the second mortgage off completely before any restructuring of the insured first mortgage.

HUD response: To the extent the LIHTC rents are lower than comparable market rents, the first mortgage should be sized accordingly. While the section 8 assistance remains in place, all extra net cash flow will be applied to payment of the second mortgage so that the owner does not benefit unduly from this sizing of the first mortgage based on LIHTC rents. The owner or PAE could (with lender approval) request a waiver to allow a compensating decrease in the debt service coverage ratio in such cases. A specific DSC is not appropriate for the final rule; guidelines are contained in the Mark-to-Market Program Operating Procedures Guide. Generally we would expect a DSC of 1.2 but a higher ratio may be appropriate for smaller loans or to facilitate conventional financing.

2. First mortgage terms and conditions.

We received the following miscellaneous comments on first mortgage terms and conditions:

- The interest rate and DSC should be adequate to permit sale at or very near ''par''.
- ''Normal processing costs'' needs to be clarified (with examples of costs that should be included).
- The PAE should be able to continue with existing above-market terms if the lender requires this as a condition of accepting a partial claim or if the PAE thinks this is the best approach.
- A PAE certification of ''competitive'' terms should be conclusive, or a mortgagee certification should be conclusive absent bad faith or manifest error.
- HUD should allow balloon loans as conventional loans and base competitiveness of rates, processing fees, *etc.,* for conventional loans on the conventional market.

HUD response:

- The interest rate and other terms of any refinancing are expected to be competitive.
- Processing costs must be reasonable and customary as determined by the PAE (and the lender of any new financing); examples include title and closing costs, and loan origination fees.
- It is unlikely that OMHAR will approve above-market terms for any financing. To the extent the existing lender is unable to provide competitive terms, the owner should pursue alternative financing sources.
- The Operating Procedures Guide requires documentation that the terms are competitive within a reasonable range.
- Balloon payments are not acceptable. The modified or refinanced first mortgage must be fully amortizing through level monthly payment). The PAE may consider shorter amortization periods if warranted by the condition of the property and availability of financing.

3. Refinancing.

One commenter said that the existing lender must be given a reasonable opportunity to refinance before another lender is involved. Two other commenters urged HUD to support the use of the section 223(a)(7) program; suggestions included allowing OMHAR rather than FHA to handle processing and providing priority or incentives for section 223(a)(7) refinancing to finance rehabilitation. Two commenters object to requiring special HUD approval for PAE risk-sharing as unnecessary and leading to delays. Finally, a commenter said that a small (under $300 thousand) first mortgage, even if supportable by rents, would be difficult to obtain on competitive terms so that a refinancing of a small first mortgage should not be required to take out the lender who will not accept a partial payment of claim.

HUD response: The final rule requires the owner to contact the mortgagee prior to seeking other sources of funding for the Restructuring Plan. This issue is addressed in more depth in the Operating Procedures Guide and other guidance from OMHAR. The issues raised by the suggestion supporting the use of the section 223(a)(7) program involves delegations of authority within HUD and will be addressed in the Operating Procedures Guide. We are neutral as to the source of new financing so long as the terms are competitive, except to the extent that section 219 of Pub. L. 106–74 requires HUD to use risk-sharing. Questions involving PAE risk-sharing raise conflict of interest

issues to be decided on a case-by-case basis after expeditious but thorough technical reviews. We anticipate the market will set the terms of new financing, in part dependent on the size of the loan, and acknowledge that a good faith effort by the owner to obtain new financing on reasonable terms may not succeed. A PAE then may consider a Restructuring Plan with full payment by HUD of a section 541(b) claim and an increased second mortgage. However, it is not acceptable to allow above-market rents to support the existing debt due to a perceived difficulty in refinancing.

4. Second mortgage terms and conditions.

a. Interest rate. We received the following suggestions regarding interest on the second mortgage:

• Clarify in the Operating Procedures Guide that the interest rate should be low enough so that an owner is clearly likely to repay; the interest rate should be 1 percent unless HUD requests otherwise (or 0 percent if the aggregate loan amount exceeds 100 percent of value).

• Permit a 0 percent rate since it is not ruled out by the Revenue Ruling.

• Set standard at 0 percent except when that would lead to payoff of the HUD-held second and third mortgage in less than 10 years.

HUD response: For interrelated legal and policy reasons, we have elected to retain the 1 percent minimum interest rate. Our interpretation of section 517(a)(2) of MAHRA is that some interest is required to be charged on the second mortgage. The minimum rate that we have selected is nominal and should not cause undue burden on the mortgagor. Additionally, the factual premise of IRS Revenue Ruling 98–34 includes a statement that the new second mortgage ''provides for interest''.

b. Other second mortgage terms and conditions. We received the following miscellaneous comments on second mortgage terms and conditions:

• Set the term ''concurrent'' rather than ''concomitant'' with the term of the first.

• Acceleration for violation of HUD requirement should be only for material violation of a material HUD requirement, and should be allowed only after written notice to owner of the violation.

• HUD should ask for a statutory change allowing for longer terms.

• Use a standard form.

• HUD should specify conditions to be in second mortgage, consistent with first mortgage.

HUD response:

• We agree that the term ''concurrent'' is preferable.

• There are adequate safeguards in the final rule to guard against unfair acceleration of a second mortgage. Safeguards include a requirement of materiality for violations (now included expressly), and notice and an opportunity to cure prior to acceleration of a second mortgage. Additionally, the rule provides an administrative dispute and appeal procedure for any acceleration decision (unless acceleration is based on payment or termination of the first mortgage, or unauthorized sale and assumption, as provided in MAHRA).

• Alteration of the second mortgage term would require an amendment of the statute. HUD has no basis for seeking such an amendment at this time.

• The Operating Procedures Guide will provide a standard form for second mortgages. The terms of the second mortgage are largely set by MAHRA and are detailed in the final rule and the Operating Procedures Guide. The second mortgage is different in nature from the first mortgage and will not be identical to the first mortgage.

5. Forgiveness/modification of second mortgage.

Two commenters said that forgiveness/modification should be available for a priority purchaser whether or not the property has been disqualified for restructuring under existing ownership. One commenter argued that forgiveness should also be allowed for a limited partnership purchaser controlled by priority purchaser.

HUD response: Section 401.461(b)(5) of the final rule allows modification or forgiveness of the second mortgage if certain conditions are met. This availability of modification or forgiveness is not dependent on the existing owners being disqualified from restructuring. See Section II.A.1.c. of this preamble for a discussion of a limited partnership controlled by a public body.

6. Return to owner.

One commenter opposed allowing the PAE to set the owner's share of net cash flow below 25 percent, arguing that a lower share will discourage owners from restructuring. Another commenter said that an owner right to 25 percent may be incentive for owners to neglect upkeep of project (*i.e.,* in order to reduce expenses and boost net cash flow) and that tenants should be involved in determining if a project meets the property management standards as a precondition to paying the owner share.

HUD response: HUD is sensitive to the fact that restructured projects (particularly those with large decreases in rents) will have tighter operating budgets and thus will require larger debt service coverage ratios to compensate. Section 517(a)(3) of MAHRA restricts the owner's return to a maximum of 25 percent of Net Cash Flow. There is no statutory provision for additional return to an owner, even for exception rent projects or other projects that may previously had an approved rate of return that would permit larger payments to the owner. Section 514(g)(3)(D) of MAHRA provides for an allowance for a reasonable rate of return to the owner when determining the level of exception rents, but we do not consider this an allowance for an additional owner return beyond that permitted for non-exception rent projects. The setting of rents above market will provide for the return permitted by section 517(a)(3) (assuming the owner's operation of the project is efficient so that Net Cash Flow meets or exceeds the underwriting estimate.)

While the typical return permitted by a Restructuring Plan will not be less than 25 percent of the Net Cash Flow, the PAE will retain discretion to negotiate the amount on a case-by-case basis. Further, to the extent the potential for LIHTC rents in the absence of project-based assistance constrains net operating income for underwriting purposes, the project will effectively be oversubsidized during the time project-based section 8 assistance is provided. The portion of Net Cash Flow to pay the second mortgage must be increased accordingly. HUD or the PAE will require the project meet management and physical condition standards as a condition of distribution of the owner's portion of the net cash flow. Tenants (and other interested parties) can address their concerns to HUD or the PAE.

7. Third mortgage.

Four commenters opposed the possibility of a HUD-held third mortgage as provided in the interim rule. One said it would lead to ''overleveraging'' a project; two others said a third mortgage should be limited to an amount reasonably likely to be repaid that was excluded from the second only because of statutory limitations on the aggregate of the first and second mortgages. Another commenter suggested using budget-based exception rents whenever a third mortgage would otherwise be needed. Another commenter asked when a HUD-held third mortgage would be forgivable.

HUD response: A third mortgage, when necessary, would not ''overleverage'' a project. First, it would require no payments on principal or interest until the second mortgage is satisfied. Second, a third mortgage would accrue only nominal interest and this interest will not compound. Third, the final rule allows a PAE to negotiate a reduction of the maximum third mortgage amount that would otherwise be required initially under a Restructuring Plan, within limits set by HUD, in order to recognize the imputed tax consequences to the owner of the restructuring. The Operating Procedures Guide will initially allow the PAE to negotiate a reduction of the initial mortgage amount by up to 30 percent. Finally, the final rule permits HUD to forgive or modify the third mortgage on the same conditions as apply to a second mortgage under § 401.461(b)(5). Exception rents are designed to address specific housing needs of tenants and communities and may not be used solely to prevent a section 541(b) claim. Accordingly, we have rejected the suggestion to use budget-based exception rents whenever a third mortgage is required.

8. Claims.

One commenter said the rule should include in the partial claim amount accrued interest on the mortgage amount to be prepaid by the claim at the note rate up to the date of prepayment. Another commenter concluded that payment only of a partial rather than a full claim would mean that exception rents would never be allowed under § 401.411(b) because that provision makes no allowance for payment of any first mortgage debt remaining after a claim payment. A commenter said that HUD should clarify in the final rule that a servicer incurs no obligation to Ginnie Mae security holders for accepting a ''compelled'' partial payment from HUD, and HUD should indemnify the lender.

HUD response: When HUD pays an insurance claim for a mortgage that is in default, the claim includes an amount for the unpaid interest that would have been included in the defaulted payments. There is no similar need to compensate the mortgagee through a section 541(b) claim, which is made only for a mortgage that is not in default. The commenter is correct that HUD will restrict debt service paid from exception rents to payments on the second mortgage for negative Net Operating Income projects or to payments on a new rehabilitation loan, but exception rents will be needed only for projects which also require a full payment of claim and which, thus, will not continue the existing first mortgage even at a nominal level. We have no legal authority, or program interest, in becoming involved in a lender's relationships with Ginnie Mae security holders. Moreover, the commenter's concern about ''compelled'' partial claim payments is unfounded. Under the final rule, OMHAR or FHA will not compel a lender to accept a partial claim payment. If the lender is not able to obtain approvals from investors, such as Ginnie Mae security holders, needed to accept a partial claim payment, the owner must refinance the first mortgage with a lender willing to make a new loan that will pay off the first mortgage amount in excess of the partial claim payment.

L. Sections 401.472–.473, Funding of Rehabilitation

Summary of Sections

Section 517(b)(7) of MAHRA and § 401.472 identify some potential sources for funding needed for rehabilitation of the project. The interim rule includes the requirement of section 517(b)(7)(B) of MAHRA that an owner contribute from non-project funds at least 20 percent of the total cost of rehabilitation. The preamble to the interim rule stated that a reasonable proportion of the owner's contribution must come from non-governmental resources, which we estimate would be a minimum of 3 percent of the total cost of rehabilitation. One of the potential Governmental sources of rehabilitation funding is the grants authorized by section 236(s) of the National Housing Act. Section 401.473 addresses the use of these grants in connection with restructuring.

Summary of Comments

1. Opposition to 20 percent owner contribution requirement.

Three commenters wanted HUD to exempt nonprofit owners from the requirement for a contribution of 20 percent of rehabilitation expenses. One commenter observed generally that owners of all types are unlikely to contribute 20 percent. Four others opposed the requirement without an incentive to make the contribution. These commenters suggested treating the contribution as a self-amortizing market-rate loan to the project that would be repayable as project expense, or providing some type of priority return or some set rate of return.

HUD response: The owner contribution is required by section 517(b)(7) of MAHRA and the return to the owner is constrained by section 517(a)(3) of MAHRA. Other than the exemption permitted by statute for housing cooperatives, nonprofit owners cannot be exempted from the owner contribution requirement without a statutory change. Eighty percent of the rehabilitation costs will come from sources other than owner contributions, and the interim rule preamble and Operating Procedures Guide both allow the owner to include any available funds from other government sources to meet their contribution requirements, except as discussed in the following topic.

2. Opposition to limit on funding from governmental resources.

One commenter opposed a limitation on funding from nongovernmental sources while another said that any such limitation needed to be in the rule. Five commenters said that all nonprofit owners should be exempt from the limitation, while two others said the PAE should be able to waive it for nonprofit owners. Two commenters asked HUD to clarify that equity raised by syndicating Low-Income Housing Tax Credits (LIHTC) is a non-governmental source of funding.

HUD response: The preamble to the interim rule contained two points of elaboration on the 20 percent owner contribution requirement that appears in MAHRA and in the interim rule. The preamble stated that a ''reasonable proportion'' must come from non-governmental sources, and estimated that this proportion would be set at a minimum of 3 percent. We continue to believe that it is reasonable to expect each owner to contribute towards the cost of rehabilitation from the owner's own resources, because the owner will benefit from the resulting increase in project value. We recognize that owners of restructured projects may have severe limitations on the ability to make additional investment in the project, but in cases where other public funds are available, owners will cover only a small part of the costs from their own resources. The commenters did not provide convincing evidence that these preamble requirements would prevent PAEs from developing Restructuring Plans with all necessary and cost-effective rehabilitation—whether for for-profit or non-profit owners. Because of the substantive impact of our decision to require owners to use their own resources toward partial implementation of the statutory requirement for an owner contribution, we have decided that the matter properly belongs in the text of the final rule itself. The precise level of required non-governmental resources, however, will continue to be set in the Operating Procedures Guide.

PAEs will have limited ability to request waivers of this regulatory requirement in exceptional cases (*e.g.* to facilitate the transfer of a troubled project to a priority purchaser), but no waiver is possible for the statutory 20 percent requirement. As stated above, MAHRA permits housing cooperatives to be exempted from the owner contribution requirement. Broadening this exemption option would require a statutory change. Equity contributions from the syndication of LIHTC will be considered a non-governmental source of funding for rehabilitation funding purposes, but will trigger a thorough technical review of the Restructuring Plan.

3. Other comments regarding 20 percent requirement.

One commenter wanted HUD to clarify that non-Federal government funding such as State/local grants or loans will be counted in the 20 percent owner contribution. Three commenters asked about borrowed funds as part of the contribution; one of them specifically mentioned insured section 223(a)(7) or 223(f) refinancing loans secured by the project and another mentioned conventional refinancing of the project. One commenter wanted the rule to specify conditions for a PAE requirement for a contribution of more than 20 percent.

HUD response: FHA-insured loans (or conventional secured debt that is not subordinate to the § 401.461 second and third mortgages) are considered project resources and may not be used to fund the owner's contribution. The PAE has discretion to negotiate a larger owner contribution. State/local grants or loans can be used to meet most of the owner's contribution. OMHAR has provided further guidance in its Operating Procedures Guide concerning the source of funds that an owner may utilize toward rehabilitation financing.

4. Comments regarding use of project accounts for rehabilitation.

One commenter cautioned against violating an owner's contract right under the regulatory agreement to distribution of surplus cash. Another commenter suggested that the lender for a conventional refinanced first mortgage should be able to use funds in project accounts to establish escrows and reserves required by the lender's usual underwriting standards.

HUD response: Section 517(a)(3) of MAHRA changes the distribution of surplus cash. The first and second mortgages for a project restructured under the Mark-to-Market Program will reflect the statutory change. As part of a closing, owners will be required to execute a Modification of Regulatory Agreement. It will modify the terms of an old or new FHA Regulatory Agreement, reference the Restructuring Plan documents as controlling the owner's distribution, and specifically delete the requirement of a residual receipts account as long as the second or third mortgages are in place. In a non-FHA refinancing the existing Regulatory Agreement is canceled.

Section 517(b)(6) of MAHRA authorizes use of project accounts in connection with restructuring but does not preclude a PAE (as part of a Restructuring Plan involving conventional financing) from recommending the use of existing project account balances to fund the initial deposit to a new reserve for replacement account or to fund tax and insurance escrows.

5. Section 236(s) rehabilitation grants.

Three commenters said that HUD should target rehabilitation grants to new priority purchasers as well as existing nonprofit owners for projects undergoing restructuring; two of them also said that section 236(s) grants should be available on a preferential basis to nonprofit owners or below-market projects renewing under part 402 without restructuring. Two commenters pointed out that treating section 236(s) grants in a rule only for projects undergoing restructuring (*i.e.,* part 401) puts exception projects seeking grant money at a disadvantage; one of them asked that HUD add a new section to part 402 on section 236(s) grants. Finally, one commenter asked whether section 236(s) grants can be structured as loans to avoid adverse tax consequences to owners.

HUD response: As noted in the preamble to the interim rule, HUD is pursuing a separate rulemaking procedure regarding use of the section 236(s) grant authority outside of the Mark-to-Market program. To the extent a Mark-to-Market restructuring generates Interest Reduction Payment (IRP) recaptures, those funds will be used to assist with rehabilitation financing for the restructured property, or for other properties through procedures to be defined in the separate rulemaking.

6. Funding of rehabilitation through claim amount.

A commenter suggested that HUD's intent behind § 401.472(a)(2) regarding facilitating rehabilitation through the claim amount was to permit the claim to be large enough to reduce the first mortgage debt so the project rents could support a refinanced first mortgage that paid off remaining debt and financed rehabilitation. Another commenter suggested that it would be simpler to pay rehabilitation costs directly from the FHA insurance fund instead of through a larger partial claim/smaller first mortgage.

HUD response: The first commenter has correctly interpreted HUD's intent in § 401.472(a)(2). Unlike the demonstration program, the Mark-to-Market Program does not include HUD authority to directly fund rehabilitation through a payment from the FHA insurance fund as suggested.

M. Section 401.480 Sale or Transfer of Project

Summary of Section

This section covers the sale or transfer of a project undergoing restructuring at the owner's initiative (*i.e.*, a voluntary sale) or following a determination that the current owner is ineligible for restructuring (*i.e.*, an involuntary sale). A PAE will develop a Restructuring Plan with an involuntary sale only if, within 30 days of notice of rejection, the owner notifies HUD or the PAE of the owner's intent to transfer the property. The owner must also provide a notice to potential purchasers that describes the project and the procedure for submitting purchaser offers; the notice is subject to review and approval by HUD or the PAE. The owner must distribute and publish an approved notice as required by HUD. This section gives a preference to certain ''priority purchaser'' groups, defined as tenant organizations, tenant-endorsed community-based nonprofit organizations, and tenant-endorsed public agency purchasers. The owner must inform the PAE of any intention to accept a purchase offer. An eligible owner desiring to sell or transfer a project through a voluntary sale should provide notice as part of its initial request for a Restructuring Plan or at any later time when it is still feasible to develop a Restructuring Plan involving sale or transfer, but the owner is not otherwise subject to the requirements of this section. All project sales are subject to PAE approval and HUD approval of the Restructuring Plan.

Summary of Comments

1. HUD should be responsible for sale of projects.

Three commenters felt that, in order to better protect the interests of tenants, HUD should maintain overall responsibility for the sale of projects.

HUD response: OMHAR will maintain overall responsibility for all aspects of the Mark-to-Market program, including approval of the sale of projects. We will carefully review PAE recommendations and input from tenant and local

community groups, whenever a project is proposed for sale or transfer.

2. Preferences for priority purchasers.

Four commenters were concerned about preferences for priority purchasers. One commenter argued that the interim rule improperly creates an absolute priority instead of the preference provided in MAHRA. The commenter further argued that, in the case of voluntary sales unrelated to disqualification, MAHRA does not support even a preference for priority purchasers and the owner should have sole discretion to choose the project purchaser. Three commenters questioned the rationale for granting a preference to priority purchasers because tenant and community-based groups are not necessarily better at maintaining a project as decent, safe, and affordable housing than other nonprofit or for-profit groups. According to the commenters, qualified nonprofit or for-profit groups could include organizations that would not meet the definition of priority purchaser because of a city-wide mandate or a tenant-endorsed non-profit housing group with a demonstrated track record.

HUD response: In the event of an involuntary sale or transfer of a project, the Operating Procedures Guide will permit offers to be accepted only from priority purchasers during a reasonable period (to be determined by HUD, currently 4 months) after notice of sale or transfer. After that period there are no restrictions on sale or transfer of the project. The rule also states that voluntary sales or transfers do not have any priority purchaser requirements. The preference for priority purchasers in the event of involuntary sale or transfer is based on the requirements of MAHRA and HUD's goal of maintaining safe and affordable housing for low income individuals and families. Priority purchaser offers will be subject to substantive review by both the PAE and OMHAR. Offers will be rejected if not in the best interest of the community and HUD. MAHRA requires priority purchasers to have a local community or tenant base. Otherwise-capable non-profits can partner with such groups to obtain this preference.

3. Priority purchasers and competitive sales.

Four commenters were concerned about the effect of the preference for priority purchasers on an owner's ability to demand competitive offers. Two commenters suggested that the final rule should clarify how long an owner must hold a property exclusively for sale to priority purchasers and what actions an owner must take to demonstrate a good faith effort to sell to a priority purchaser. One of these commenters felt that PAEs should not be required to withhold approval of a sale to a non-priority purchaser for an unreasonably long period of time. One commenter felt that the final rule should give wide discretion to the PAE to approve non-priority purchasers and that the PAE should be able to waive the requirement for tenant approval if approval is unreasonably withheld.

HUD response: Priority purchasers will have a preference only in the event of an involuntary sale or transfer of a project, and then only for a limited period of time. This preference should have a minimal impact on an owner's ability to demand competitive offers because the Operating Procedures Guide requires that priority (and all) purchaser offers be reviewed carefully by both the PAE and OMHAR. The Operating Procedures Guide also requires that the PAE must attempt to mitigate losses to the Government while not placing sole priority on purchase price. In the event the PAE believes tenant approval is being unreasonably withheld, OMHAR should be consulted on a case-by-case basis.

N. Sections 401.481–.484, Other Requirements of Restructuring Plan

Summary of Sections

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

Section 514(e)(9) of MAHRA prohibits refusal to lease a ''reasonable number'' of units to section 8 voucher holders because of their status as voucher holders. Under § 401.483 of the interim rule (§ 401.556 of the final rule), the Restructuring Plan will not permit an owner to reject any prospective tenants solely because of their status as voucher holders. (Note that title V of Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, merged the voucher and certificate programs into a consolidated voucher program. HUD has proposed to Congress technical corrective legislation that will conform MAHRA to this change. The final rule refers solely to vouchers to carry out clear Congressional intent, but the term ''vouchers'' is defined to include any tenant-based assistance under the definition in MAHRA, which is also the section 8 definition.)

Section 401.484 of the interim rule (§ 401.560 of the final rule) implements part of section 518 of MAHRA, which requires a PAE to establish management standards for a project pursuant to HUD guidelines and consistent with industry standards.

Summary of Comments

1. Subsidy layering limitations on HUD funds.

One commenter was ''pleased'' that HUD allows PAEs with delegated authority for subsidy layering to serve that function under MAHRA. Another commenter questioned the interim rule's reference to limiting assistance to that needed to continue housing ''tenants with an income mix comparable to the income mix of the project'' before restructuring. The commenter asked how this could be reconciled with a possible need to reconfigure project (*e.g.*, convert efficiencies to 1-bedroom units).

HUD response: We do not intend to limit the ability of owners to reconfigure projects and we thank this commenter for pointing out this potential misunderstanding. We have amended language in § 401.481 to address this issue.

2. Leasing units to voucher holders.

Among commenters favorable to this section, one generally supported it, another wanted the 100 percent requirement to be in a recorded instrument as well as in the Restructuring Plan, and the third wanted HUD to require an owner to ''seek and accept'' tenant-based assistance for units without project-based assistance. Two commenters opposed the section, stating that it is unreasonable to require 100 percent of units to have tenant-based assistance and that HUD should encourage mixed-income projects. One of them specifically objected to requiring an owner to accept tenant-based assistance that does not permit the owner to realize market rents. One commenter said that the rule needs to specify the term during which this section applies. Three commenters suggested that owners should not be under an obligation to

renew tenant-based contracts unless the tenant is lease-compliant. One commenter was concerned that this section could establish an unconditional renewable lease.

HUD response: We agree with the comment that the non-discrimination provision of § 401.483 of the interim rule (§ 401.556 of the final rule) should be included in the recorded Use Agreement and we have amended § 401.408 accordingly. The final rule does not require an owner to renew contracts with non-compliant lease holders and HUD will not require owners to ''seek and accept'' tenants with tenant-based assistance. The final rule merely prohibits the owner from discriminating solely on the basis of the tenant's (or potential tenant's) status as the holder of a section 8 voucher. The rule does not require the owner to rent to tenants who are unable to pay the rent or are otherwise not in compliance with the terms of a lease.

3. Property management standards.

a. Need uniform standards. One commenter urged HUD to establish uniform standards that reflect expected outcomes.

HUD response: The final rule reflects the statutory requirement that the PAE establish management standards consistent with industry standards and with minimum general requirements from HUD (section 518 of MAHRA). More specific guidance on reporting and compliance is in the Operating Procedures Guide. Projects with FHA mortgage insurance or a HUD-held mortgage after restructuring will be required to comply with the Regulatory Agreement and all relevant HUD Handbooks and Directives (including the HUD Real Estate Assessment Center's procedures), except to the extent specifically modified by the Restructuring Plan, the Operating Procedures Guide, the final rule, or MAHRA.

b. Suggestions for language changes. Two commenters urged HUD to make the requirement for a manager to maintain good relations with tenants more objective (*e.g.*, it should relate to tenants' opportunity to comment and respect for tenants' rights, not the level of tenant satisfaction with manager). One of these commenters also said that a reference in the preamble to less than ''satisfactory'' HUD review should apply only if a PAE agrees with HUD findings and the findings are not cured in reasonable period after notice. The same commenter suggested the following specific language changes:

- Add to paragraph (b) an express requirement for HUD's guidelines to be consistent with industry standards.
- Strike ''through preventative maintenance, repair or replacement'' from paragraph (b)(1) to avoid unproductive arguments over methods of achieving goal.
- Delete an unclear reference in (b)(2) to routine cleaning—which the commenter said duplicates provisions of the physical condition standards.
- Add a provision that a management agreement should permit the PAE to terminate the manager for cause.

HUD response: In our opinion, the commenter's suggested language regarding tenant relations is less, not more, objective. Adding ''consistent with industry standards'' to paragraph (b) is redundant since it is already specified in paragraph (a). The language regarding ''preventative maintenance, repair or replacement'' is necessarily more specific than just requiring maintenance of the long term physical integrity of the property. The requirement for routine cleaning, while admittedly duplicative, is appropriate for an explicit statement in this context. HUD does not at this time contemplate delegating the authority to require new management; the Regulatory Agreement/Management Certification contains a provision permitting HUD to require the owner terminate the management agreement.

c. Management fees.

Two commenters wanted HUD to ensure a management fee system that provides adequate compensation and removes the link to (possibly falling) rent levels or that carries forth current method with higher percentage of rent to reflect drop in restructured rents. Another commenter asked HUD to clarify that allowable management fees will not be reduced as a result of restructuring.

HUD response: Underwriting standards for management fees (and other operating expenses) are detailed in the Operating Procedures Guide. While management fees may well be reduced as a result of restructuring, the fee should be adequate to competently manage the property as an affordable housing resource. To the extent the fee has been based on a percentage of the gross rent and will be inadequate after reducing the rents as a result of restructuring, the percentage yield will be recalculated based on an adjusted comparable market fee and adjusted with the OCAF.

O. Sections 401.500–401.501, Participation by Tenants, Community, and Local Government

Summary of Sections

Under §§ 401.500 and 401.501, a PAE must solicit and document the consideration of tenant and local community comments. These sections (and the related new §§ 401.502 and 401.503 in the final rule) describe the minimum procedures for ensuring that third parties affected by the restructuring of a project through the Mark-to-Market Program are kept informed and provided the opportunity to provide comments at crucial stages of the process, including required notices and public meetings at which the PAE will hear presentations and receive comments on the desired contents of a Restructuring Plan and a Rental Assistance Assessment Plan (if one is required), and on any proposed transfer of the project.

Summary of Comments

In the following summary we have included all comments relating to participation by tenants in the restructuring, implementation and contract renewal process, even if the comments were specifically directed to a subject covered in a different section of part 401 or part 402.

1. General.

A significant percentage of commenters (approximately 26 commenters) were dissatisfied with the level of tenant, community, and local government participation guaranteed by §§ 401.500 and 401.501 of the interim rule. These commenters all felt that tenants, and the community and local government, needed to be given the opportunity for broad participation in the entire restructuring process.

Almost all of the commenters argued that broad tenant and community participation was vital for the success of the Mark-to-Market Program. A few commenters also argued that the interim rule failed to follow both the letter and the intent of MAHRA by not providing tenants with the ability to offer ''timely and meaningful'' input at the various stages of the restructuring process. Some commenters specifically cited section 514(f)(2)(c) of MAHRA as requiring that tenants be consulted on the completed rental assistance assessment plan.

The following table summarizes the general suggestions made by commenters (a number of more specific subject areas are discussed later):

Suggestion	Number of commenters
Tenants should participate fully in PAE selection	6
Tenants should participate in decisions to find an owner ineligible for restructuring or section 8 renewals	2
Tenants/community should have right to have access to relevant documents and information, before they are final, in order to be able to give meaningful input to documents and the overall process. For example, right to access to draft appraisals, physical condition analyses, rental assistance assessment plans, capital needs assessments, management reviews, comparable market rent analyses, proposed restructuring plan, data used in making any decisions about the need for project versus tenant-based assistance, cost-effectiveness of rehabilitations, or disqualification of the owner, and other information necessary for meaningful tenant input	10
Funds should be provided either to PAE or tenant groups to support tenant participation activities	4
Tenants/community should be given notice of and allowed to participate fully in all aspects of restructuring process. For example, in developing and/or reviewing rehabilitation analysis restructuring plan, cost-effectiveness determination under § 401.451(c), any proposed transfer of property, eligibility/disqualification decisions, restructuring/renewal decisions, development of PRA, negotiation of Restructuring Plans, conversions to tenant-based assistance, formulation of rehabilitation and management assessments, Restructuring Commitments	18
Tenant participation and notice in monitoring of PAE's actions under PRA, and further participation of tenants in future implementation and enforcement of the Restructuring Plan, is needed	7
Many more meetings should be required and public comments accepted throughout entire restructuring process	6

HUD response: HUD recognizes the importance of providing opportunities for full and informed involvement in all aspects of project restructuring. Such opportunities, however, must be provided in a manner that permits efficient and timely development of a Restructuring Plan that responds not only to tenant needs but also to wider community and local government needs, the needs of project owners, and the social and financial goals of the Federal Government reflected in MAHRA. HUD considers the tenant participation opportunities provided in the interim rule as consistent with the express minimum demands of MAHRA, but we agree with the commenters that the final rule should require more in order to implement the spirit of the statute. While it is important to streamline the restructuring process and to allow the PAEs flexibility to respond to local conditions, we share the commenters' concerns that the interim rule was not prescriptive enough to guarantee that the tenants and local community groups would be provided adequate opportunity for meaningful participation in every case.

In the interests of providing even greater opportunities, we have concluded that a second consultation meeting should be mandated as an opportunity for tenants and local community groups to review and comment on the PAE's proposed Restructuring Plan (including plans for future section 8 assistance) before the PAE submits the Restructuring Plan to OMHAR. As a minimum, the PAE will be required to conduct two (rather than just one) public meetings. Section 401.500(c) and (d) now require public access to the draft Restructuring Plan and a second meeting no later than 10 days prior to submission to OMHAR. The PAE must document and provide a brief narrative explanation of the disposition of all tenant and local community comments.

This revised procedure will not only ensure appropriate early input into the development of the Restructuring Plan, but also will provide a safeguard against inadequate consideration or misunderstanding of tenant and community concerns by the PAE, without unduly hampering timely and efficient completion of the Restructuring Plan. Persons given the opportunity to comment on a proposed Restructuring Plan will not have appeal rights under subpart F. HUD emphasizes that the tenant and community participation procedures mandated by the final rule are minimum procedures that may be supplemented by a PAE to the extent consistent with the objectives of MAHRA and the local circumstances. Other changes intended to strengthen HUD's collaborative efforts with tenants and local communities are detailed in the following sections.

2. Involve others in Rental Assistance Assessment Plan.

Two commenters said that the PAE needed to consult with tenants, the locality, the PHA and the owner before developing this plan, and specifically with regard to the tenants' ability to use tenant-based assistance. Five commenters said that tenants should have a right to comment on the plan after it was developed, with some commenters arguing that this is required by section 515(f)(2)(C) of MAHRA. One commenter suggested that any conversion to tenant-based assistance should require the approval of ⅔ of the tenants.

HUD response: The initial consultation meeting required by the interim rule provides the opportunity requested by commenters for input prior to the development of the Rental Assistance Assessment Plan. HUD does not interpret section 515(f)(2)(C) as requiring an additional opportunity for tenant comment after that plan is completed, but will provide such opportunity as part of the second consultation meeting to be held upon completion of the draft Restructuring Plan as described above.

3. Intermediaries administering technical assistance grants should receive notice.

One commenter suggested that Intermediaries administering technical assistance grants for the Mark-to-Market Program should be recognized as ''affected parties'' for the purpose of receiving notices. This commenter felt that this information was required for Intermediaries to perform their functions in a timely and efficient manner.

HUD response: HUD agrees that this requirement is appropriate.

4. Notices in other languages.

One commenter suggested that notices be provided in other languages.

HUD response: HUD will publish general information brochures in various languages. While the PAE and the owner should make every effort to provide notices (or translation services) to reach non-English speaking tenants and local community groups, it is impractical to require this by regulation.

5. Notice to all tenants and posted in project.

A number of commenters felt that all notices should be delivered to each tenant and tenant organization, as well as posted in each project.

HUD response: HUD agrees with this comment.

6. Right to organize.

Tenants should be able to organize in projects that have been restructured through the Mark-to-Market Program.

HUD response: As explained in HUD's corrective rule published on

December 28, 1998 at 63 FR 71373, section 599 of Pub. L. 105–276 amended section 202 of the Housing and Community Amendments of 1978, concerning tenant participation in certain multifamily housing projects, to apply that section to all projects with project-based assistance or enhanced (''sticky'') vouchers under the Mark-to-Market Program. Tenant participation under section 202 (including the right to organize) is the subject of 24 CFR part 245. We issued a separate proposed rule to amend part 245 to reflect section 599 and to make other changes (64 FR 32781, June 17, 1999). A final rule is being developed.

7. Tenant role in PAE selection.

Three commenters were concerned that tenants were not given any role in selecting PAEs. Two commenters also felt that tenants should have a role in the negotiation and renewal of PAE agreements. One commenter pointed out that since PAEs would be making decisions about the future of tenants' homes, it would be vital for tenants to have a say in their selection.

HUD response: We encourage tenants to work with the PAEs. Experience working with the tenants has been a threshold criterion in selecting the PAEs. OMHAR will take appropriate action if justified complaints against a PAE are received from tenants.

8. Rent levels.

One commenter said that PAEs will not be able to adequately review an owner's initial market rent determination, so that HUD must let tenants/community advocates review and comment. Three commenters argued that tenants should have the right to comment on or appeal proposed rent increases or petition for decreases to match cost decreases.

HUD response: The PAEs' market knowledge and ability to manage the independent third party review appraisal function were threshold criteria in selecting the PAEs. The PAE is, however, required to solicit tenant and local community comment on this and other issues in the context of developing the Restructuring Plan. While tenants and other interested parties may comment on rent adjustments, they will not have an appeal right.

9. Use Agreement changes.

A commenter felt that tenants and tenant organizations should be notified of any changes to the Use Agreement.

HUD response: HUD agrees with this comment.

10. Monitoring and compliance activities.

A number of commenters were concerned that tenant participation was not sufficient in monitoring and compliance activities. One commenter felt that the final rule should give tenants and the community the right to enforce the Restructuring Plan to achieve compliance. Another commenter felt that tenants and other affected third parties should be given notice of all monitoring and compliance visits.

HUD response: Tenants and other groups are specifically listed as third party beneficiaries of the Use Agreement in § 401.408(i) of the final rule. Appropriate notice of monitoring and compliance inspections will be provided.

11. Transfer of properties and tenant participation.

Three commenters emphasized that the final rule should require more tenant participation in the transfer process. One of these commenters felt that the final rule should require that the PAE work with tenant and community groups and local governments to facilitate the transfer of properties to priority purchasers. Another commenter was concerned that the requirement for an ineligible owner to respond to a notice of rejection within 30 days with a notice of intent to sell would lead to HUD foreclosures when owners fail to respond within 30 days. In light of the adverse impact of foreclosure on tenants, the commenter wanted a final rule that requires community and tenant participation and places primary responsibility on the regulatory agencies to develop a proper solution using all available enforcement tools. Another commenter felt that HUD/PAEs should be obligated early in the disqualification process to explore transfer options with owners, tenants, and potential priority purchasers because reliance on end-stage notices by largely unmotivated owners would be neither adequate nor timely.

HUD response: The final rule requires extensive tenant participation in the involuntary sale or transfer process when the sale or transfer is to a priority purchaser. The potential priority purchaser must show evidence of tenant support and tenant endorsement prior to approval of the sale or transfer. If an owner is determined to be ineligible, HUD will make all efforts to prevent foreclosure and to facilitate sale or transfer of the project to an eligible owner. To the extent an owner is not responsive within the 30-day notice period, HUD's Office of Housing will make the determination of whether to terminate the section 8 contract or to renew at market rents. In all cases the impact on the tenants and local community will be carefully considered. These efforts will be coordinated with HUD's Enforcement Center and other offices within HUD. We agree with the commenter that it is vital for the PAE to determine if a transfer is appropriate (whether voluntary, or involuntary in the case of rejected owners) early in the process.

12. Tenant involvement for projects not restructured.

Eight commenters wanted the final rule to provide for tenant involvement in contract renewal decisions, including determinations of owner ineligibility, for projects not undergoing restructuring under the Mark-to-Market Program.

HUD response: Some of these comments concerned projects that were eligible for restructuring but with owners that requested a contract renewal without restructuring. As regards those projects, HUD agrees with this comment and has provided a new notice requirement and opportunity for comment in the new § 401.502. HUD's response regarding ineligible projects will be published with the final part 402.

13. Access to information.

Ten commenters thought that tenants and/or the community should have a right of access to relevant documents and information, before restructuring is final, in order to be able to give meaningful input to documents and the overall process. Documents/information mentioned included draft appraisals, physical condition analyses, rental assistance assessment plans, capital needs assessments, management reviews, comparable market rent analyses, proposed restructuring plan, data used in making any decisions about the need for project versus tenant-based assistance, cost-effectiveness of rehabilitations, or disqualification of the owner, and other information necessary for meaningful tenant input.

HUD response: Effective participation by tenants and the community depends on access to basic project information. This is recognized in MAHRA section 514(f)(1), which requires HUD to establish an opportunity for participation that must include ''appropriate access to relevant information about restructuring activities''. Many commenters felt that the interim rule was not adequately specific in emphasizing the right to such access. The interim rule generally requires the PAE to solicit tenant and local community comments at an early stage. By expressly designating the PAE as the key player under the interim rule, HUD expected that the PAE would make available in an appropriate manner the types of information that would make such a solicitation meaningful. The

interim rule did not attempt to list the specific types of documents or information that would need to be made available, or state precisely where and when they would be available, but instead focused on ensuring that a formal procedure was available to receive informed input from tenants and the community.

In response to a broadly-felt desire for an explicit statement in the final rule regarding access to information, the final rule includes both a general statement of the PAE's responsibilities in this regard and a specific listing of certain types of information that a PAE otherwise might be reluctant to disclose publicly because of potential owner assertions of proprietary or confidentiality rights to such information. By clearly listing such information in a rule, HUD will make clearer HUD's understanding that compliance with the statutory mandate for tenant and community participation necessarily means that an owner requesting restructuring must give up some rights to confidentiality that would ordinarily prevail.

We are not listing in the final rule all information items for which a PAE is expected to, or may find it appropriate to, provide public access. For example, business information of a type routinely submitted to HUD that would be released in response to a proper information request under the Freedom of Information Act is not listed. We are not listing items that are a matter of public record. We will not expect a PAE to make public information obtained from an owner that is clearly confidential, or propriety business information of a type that HUD would normally decline to make available, in the absence of a specific rule requiring disclosure. OMHAR is considering a separate proposed rulemaking procedure that will cover in more detail the issue of public access to owner-provided information in the context of Restructuring Plan development, and OMHAR welcomes all ideas on that subject.

P. Sections 401.550–.554, Implementation of the Restructuring Plan After Closing

Summary of Sections

Section 401.550 implements section 519 of MAHRA by providing for periodic PAE monitoring (including on-site inspections) and by generally requiring PAEs to ensure that owners comply with approved Restructuring Plans, including execution and recording of a Use Agreement. As long as there is a PAE for the project that is qualified to be a section 8 administrator (*i.e.,* a State or local housing agency), the PAE will be responsible for monitoring and enforcement; if not, HUD will perform those functions. HUD or its designee will be responsible for servicing the second mortgage including the determination of the amount of the net cash flow receivable by the owner. HUD may designate the PAE as servicer with consent of the PAE. Section 401.554 requires HUD to offer to any PAE qualified to be the section 8 contract administrator the opportunity to serve as contract administrator. The term ''qualified'' is intended to indicate that a contract administrator must meet both statutory requirements of the United States Housing Act of 1937 (*e.g.,* be a public housing agency) and any additional requirements of HUD established under the applicable section 8 program by the responsible HUD officials. As contract administrator, the PAE must offer to renew section 8 contracts in accordance with the Restructuring Plan as provided in section 515(a) of MAHRA.

Summary of Comments

1. Inspections.

Two commenters were concerned about inspections required under § 401.550(b). One commenter pointed out that properties subject to FHA-insured mortgages would be subject to two inspections, contrary to the HUD 2020 goal of requiring one inspection per property per year. Both commenters were concerned about the cost of the required inspection and the possibility that the loan servicing fee would not cover the servicing lender's costs. One suggested eliminating the mortgagee inspection requirement for small loans; the other suggested requiring the PAE to submit inspection results to the servicing lender in lieu of a mortgagee inspection.

HUD response: HUD agrees that duplicate inspections are not desirable and they are not required under the final rule. All inspection requirements for restructured projects will be consistent with the HUD Real Estate Assessment Center (REAC) protocols.

2. PAE matters.

One commenter recommended that PAEs receive additional compensation for conducting loan servicing, compliance monitoring, and section 8 contract administration. This commenter also recommended that HUD clarify all the long-term responsibilities of the PAE in the Operating Procedures Guide and the final rule. Another commenter suggested that HUD/PAE should identify the specific type of monitoring and inspection contemplated.

HUD response: The PAE's long-term responsibilities will vary according to its willingness and ability to perform these functions. The possible responsibilities are discussed in Subpart D. These matters, and appropriate compensation, will be addressed in the PRA and the Operating Procedures Guide. OMHAR is currently drafting a PRA amendment to recognize the long-term compliance monitoring functions.

3. Role of lender.

One commenter felt that if the first mortgage is refinanced with a conventional loan, then the conventional lender should have primary project monitoring and inspection authority.

HUD response: Consistent with section 519 of MAHRA, the PAE (or HUD if the project is no longer covered by a PRA with a public PAE) is responsible under the final rule for long-term monitoring and compliance with the Restructuring Plan and Use Agreement. This does not prevent the lender—whether the first mortgage is modified or refinanced with FHA-insured or conventional financing—from undertaking other monitoring or inspections that it considers appropriate, at its own expense.

4. Servicing of second mortgage.

Two commenters were concerned about the servicing of second mortgages. One of these commenters felt that the Mark-to-Market program would operate more efficiently if a servicer of a first mortgage were given the opportunity to service the second mortgage. The other commenter argued that because Mark-to-Market second mortgages will be cash flow mortgages, an important criteria for servicing them will be financial statement analysis. The commenter recommended that HUD test interest for a national solicitation for contractors who could provide the necessary expertise in analyzing financial statements.

HUD response: HUD agrees that the servicer of the second mortgage must have skill in financial statement analysis. As noted in § 401.552 of the final rule, HUD or its designee (which could include either the PAE or another contracted entity) will service the second mortgages.

5. Section 8 contract administration.

A commenter urged HUD not to attempt to undermine Congress' intent that qualified HFAs, serving as PAEs, be utilized as contract administrators for properties that complete restructuring. The commenter was concerned about the interim rule adding additional requirements for contract administrators

beyond those contained in the United States Housing Act of 1937.

HUD response: Section 401.554 implements the requirement in Section 519 of MAHRA that PAEs who are qualified to be Section 8 contract administrators be offered the opportunity to serve in this capacity. ''Qualified'' is used in the sense of both technically eligibile under the 1937 Act, and capable as determined by the responsible HUD official. HUD, or a public body PAE designated as contract administrator, must offer to renew section 8 contracts, subject to the availability of appropriations.

6. Enforcement.

A commenter asked: What will be the enforcement mechanism to enforce compliance with management standards?

HUD response: Under section 519(a)(1)(A) of MAHRA, a PAE has responsibility for enforcement of the management standards (as well as other MAHRA requirements). HUD will not shun an enforcement role, however, but will be actively involved in ensuring full compliance with program requirements. HUD and/or the PAE will apply a variety of enforcement tools in cooperation with HUD's Enforcement Center, when appropriate on a case-by-case basis. Notes, mortgages, Regulatory Agreements, Use Agreements and section 8 HAP contracts will all provide legally binding requirements upon which HUD or (to some extent) a PAE can bring enforcement action. Specific circumstances such as status of the property's financing, type and level of section 8 assistance and past PAE experiences with enforcement under Mark-to-Market and other programs will dictate the appropriate enforcement mechanism. Additionally, in every case, the recorded Use Agreement will provide recourse for the various beneficiaries.

Q. Section 401.595, Contract Provisions

Summary of Section

This section provides that the provisions of 24 CFR chapter VIII (*i.e.,* other section 8 program requirements) will apply to contracts renewed under part 401 only to the extent, if any, provided in the section 8 contract.

Summary of Comments

One commenter wanted an explanation of the section which the commenter thought was unclear. The commenter asked whether the rule referred only to regulations not required by section 8 itself, and whether HUD intended the contract to substitute for regulations governing management and operations of projects under renewed project-based assistance contracts.

HUD response: The intent of this section is to permit HUD to identify, through the contract, those section 8 regulations that are appropriately applied when renewal is under the authority of part 401. This applies only to the initial renewal under part 401. Subsequent renewals will be governed by part 402. Some matters (*e.g.,* setting initial rent levels for project-based assistance and adjusting them) are fully covered in part 401 and other section 8 regulations directly pertaining to these matters will not be applied to part 401 renewals. For some other matters, other sections of part 401 indicate the applicability of usual section 8 requirements—*e.g.,* § 401.558 indicates when the physical conditions standards in 24 CFR 5.703 (which usually apply to section 8 projects pursuant to sections such as 24 CFR 880.201 and 881.201) will apply to Mark-to-Market properties. In general, section 8 regulations on matters that are not in conflict with, or otherwise addressed by, part 401 will be made applicable in contracts renewed under that part. However, HUD considers it necessary to reserve to the contract drafting and revision process the final detailed decisions on the applicability of section 8 requirements.

R. Section 401.601 of Interim Rule and § 402.4(a)(2) of Final Rule, Consideration of an Owner's Request To Renew an Expiring Contract Without a Restructuring Plan

Summary of Section

This section provides a procedure for considering an eligible owner's request for renewal of an expiring contract without requesting a Restructuring Plan. Rents would be reduced to comparable market rents. HUD or the PAE will determine whether renewal under § 402.4 at comparable market rents would be sufficient to maintain an adequate debt service coverage ratio on the first mortgage and necessary project reserves. If so, the contract renewal will be processed under § 402.4. If not, a Restructuring Plan must be developed by a PAE before further consideration of the owner's request.

In the final rule, this section is moved without substantive change to § 402.4(a)(2), so that part 402 will contain all requirements for contract renewals under the authority of section 524 of MAHRA. When the complete part 402 is published in final form, HUD will make any further changes to § 402.4(a)(2) that are needed to reflect HUD's final resolution of the comments on this section. All of the HUD responses below relate to HUD's position pending publication of the complete final part 402.

Summary of Comments

1. Determination/verification of rent comparability.

One commenter wanted the final rule to clarify that verification of rent comparison is a responsibility of a PAE and not HUD but another said verification must be by HUD and not the PAE (arguing that a PAE has a bias to restructure). Another commenter wanted market comparable rents for projects with current rents above market to be determined by an appraiser on both an ''as-is'' and ''as-repaired'' basis, with ''as-is'' basis to be used when reserves are determined to be inadequate for repairs.

HUD response: HUD's Office of Housing will retain responsibility for renewal of below-market contracts. OMHAR will delegate the rent comparability review for above-market projects to PAEs, but will retain responsibility for the final decision. The compensation structure and assignment of these projects to PAEs for contact administration regardless of whether or not the projects are restructured will remove the basis for any perceived bias on the part of the PAE. The rents for these projects will be analyzed on an ''as is'' basis, unless the repairs will be accomplished through full restructuring with a rehabilitation escrow fully funded at closing, or as otherwise specified in the Operating Procedures Guide.

2. Determining adequacy of DSC at comparable market rents.

According to one commenter, this section should only provide for verification of the owner's determination of market rents with no underwriting (which would encourage owner opt-outs from project-based assistance contracts.) Two other commenters, however, asked for an independent HUD/PAE assessment of capital and project operating needs. Another commenter questioned the statutory basis for reviewing the adequacy of debt service coverage at comparable market rents.

HUD response: OMHAR will make a determination (on the basis of the PAE's review) that renewal with rents reduced to market rents with no debt restructuring will not jeopardize the long term financial and physical integrity of the property. Debt service coverage (at reduced rents with expected operating expenses), the adequacy of the reserves for replacement, and the physical condition

of the property will be analyzed prior to the Secretary's discretionary renewal pursuant to section 524(a).

S. Section 401.602, Tenant Protection if an Expiring Contract Is Not Renewed

Summary of Section

An owner of an eligible project is not required to request renewal of an expiring contract, but the owner must give advance notice of non-renewal as required by statute. (The underlying statutory provisions have changed since the interim rule took effect, as discussed in Section I.B. of this preamble.) In determining the application of the notice provisions of section 514(d) of MAHRA and section 8(c)(9) of the 1937 Act, as they existed when the interim rule took effect, § 401.602 of the interim rule distinguished between an owner of an eligible project who requested restructuring (considered subject to section 514(d) notice requirement) and an owner of an eligible project who did not request restructuring or who was rejected by HUD or the PAE (considered subject to the section 8(c)(9) notice requirement.) The interim rule also provided that an owner of an eligible project who does not give the proper notice must continue to permit tenants to stay in their units without increasing the tenant portion of the rent for a specified period beginning on the earlier of the date proper notice was given or the date the contract expires.

Section 401.602 of the interim rule also required HUD to make tenant-based assistance available to tenants in two circumstances: (1) To all tenants residing in units assisted under the expiring contract if the owner of an eligible project chooses not to extend or renew project-based assistance (as provided in section 514(d) of MAHRA) and (2) to all tenants residing in a project who are low-income families or are receiving tenant-based assistance at the time HUD or the PAE reject an owner of an eligible project for restructuring (as provided in section 516(d) of MAHRA). Section 401.606 of the interim rule required tenant-based assistance to be offered to each assisted family residing in a project at the time it is restructured with a conversion to tenant-based assistance. The interim rule did not address the availability of tenant-based assistance in other situations of non-renewal of project-based assistance.

Summary of Comments

1. Is tenant-based assistance discretionary or mandatory if project-based assistance is not renewed?

One commenter asked HUD to make clear in the rule that HUD expects appropriations for tenant-based assistance to protect displaced.

HUD response: Owners are required to provide adequate notice to tenants and HUD if they intend to discontinue the provision of project-based assistance, so that tenant-based assistance will be available for the tenants when the project-based assistance expires. As recently amended by section 535 of Pub. L. 106–74, section 8(o)(8)(A) of the United States Housing Act of 1937 requires the owner's notice to state that ''in the event of termination [of project-based assistance] the Department of Housing and Urban Development will provide tenant-based assistance to all eligible residents, enabling them to choose the place they wish to rent, which is likely to include the dwelling unit in which they currently reside.''

2. Notice issues.

a. 6-month notice of non-renewal. Some comments on notice to tenants addressed the interim rule provisions providing for 6-month notice in some cases and 12-month notice in others, based on HUD's interpretation of statutory provisions in effect when the interim rule was published. Subsequent legislation has changed the 6-month notice provision to a 12-month notice.

HUD response: HUD has made changes in the final rule corresponding to statutory changes and therefore comments on the 6-month notice provision are no longer germane.

b. When is notice required? Three commenters said that a failure to renew because HUD found the owner ineligible for contract renewal should not require a notice to tenants. Similarly, one commenter felt notice was not required if an owner refuses to accept a restructuring plan approved by HUD. Two others wanted tenant notice in all opt-out or non-renewal situations, including owner ineligibility and conversion to tenant-based assistance under a restructuring plan. One commenter felt that any notice requirement in connection with an ''interim'' contract renewal at existing rents under section 514(c) pending restructuring should be satisfied by notice given when the contract is approved.

HUD response: One-year notice is now required by statute regardless of the reason for termination of the contract. Additionally, new § 401.602(a)(1)(ii) of the final rule reflects the new statutory requirement (section 549(c) of Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999) that owners of projects eligible for Mark-to-Market restructuring must also give a 120 day notice of their intent to opt out.

3. Rent levels for tenant-based assistance.

One commenter questioned the lack of guidance on rent levels for enhanced vouchers for opt-outs. Two commenters said the rule should guarantee that the vouchers provided through a Restructuring Plan are ''enhanced'' or ''sticky'', and another commenter wanted the final rule to clarify whether such vouchers are enhanced. Two commenters also wanted vouchers to be enhanced whenever an owner is rejected for renewal and where an owner opts out. One commenter cited section 405(a) of the Balanced Budget Downpayment Act, I and language in appropriations Act as authority for permitting rents under some tenant-based assistance that exceed the levels of ''enhanced'' vouchers under section 515(c)(4), and relocation costs.

HUD response: Section 538 of Pub. L. 106–74 now provides uniform guidance for enhanced vouchers. It is reflected in this final rule.

4. Timing of tenant-based assistance.

Two commenters said that tenant-based assistance should be available sufficiently early prior to termination/expiration so that tenants can relocate or have assistance in place in time; one suggested 4 months. Another commenter wanted HUD to provide a short-term extension of project-based assistance to provide necessary time for tenants to prepare when an owner is rejected only a short time before the project-based assistance expires.

HUD response: These comments are generally consistent with existing HUD policy to provide adequate time for tenants to find alternative housing.

T. Section 401.606, Tenant-Based Assistance Provisions for Displaced Tenants

Summary of Section

Section 401.606 complies with section 515(c) of MAHRA by providing that, if the Restructuring Plan provides for tenant-based assistance, assistance under 24 CFR part 982 will be offered to each eligible family assisted under the section 8 project-based assistance contract on the date of expiration.

Summary of Comments

One commenter said the rule should provide that ''reasonable rent'' for section 515(c)(4) vouchers is the restructured rent in the Restructuring Plan which must be pegged to actual market rents, and that the payment

standard for the vouchers must continue to be the ''reasonable rent'' for all renewals of tenant-based assistance as long as the tenant stays in the project. Three other commenters said that since section 515(c)(4) of MAHRA is merely referenced in the interim rule, § 401.606 should expressly state that the ''reasonable rent'' shall be at comparable market rents (instead of merely not exceeding market, as stated in the statute).

HUD response: Section 538 of Pub. L. 106–74 revised the vouchers provisions of MAHRA to provide for enhanced vouchers on the same terms as enhanced vouchers authorized by other statutes. The final rule reflects this statutory change.

U. Sections 401.645 and 401.651 Owner Dispute of Rejection and Administrative Appeals

Summary of Sections

Section 401.645 provides the owner an opportunity to dispute if any of the following occur: (1) A request for a Restructuring Plan is rejected; (2) a request for a section 8 contract renewal is rejected; (3) a PAE cannot continue with a Restructuring Plan because of lack of owner cooperation under § 401.402; or (4) HUD rejects a proposed Restructuring Commitment submitted by a PAE. HUD or the PAE will notify the owner of the reasons for a rejection and provide a 30-day period to submit written objections or cure the problem. If an objection is submitted, HUD or the PAE will send the owner a final decision affirming, modifying, or reversing the initial rejection with reasons for the decision. This final decision may be appealed within 10 days through the procedures in § 401.651, which permit an owner to make a presentation (written, oral, and/or through a representative) at a conference with an official of HUD who was not involved in making the decision under appeal. The HUD or PAE official who issued the decision under appeal may also participate.

Summary of Comments

1. Tenant appeals.

Three commenters felt that the dispute and appeals procedures should be extended to tenants.

HUD response: Tenant input into administrative procedures will be welcomed whenever appropriate. Information that may give rise to the administrative proceedings referenced above will always be welcomed from all interested parties. While tenant and local community input is critical to the success of specific Restructuring Plans and to the program in general, the statute does not contemplate tenant access to the dispute and appeals procedures.

2. PAE appeals of rejections under § 401.405.

One commenter suggested that PAEs should have the right to object to HUD's rejection of a restructuring plan, given that PAEs have statutory responsibility for developing the plan. In addition, the commenter suggested that because objection and appeal by a PAE is not encompassed by section 516(b) of MAHRA, HUD is without authority to extend a final determination on the PAE's objection that is exempt from judicial review under MAHRA section 516(c).

HUD response: There is no statutory requirement to provide the PRA with a specific administrative dispute and appeal right independent of the owner, nor is the PAE likely to have any standing to pursue a judicial challenge (for which the final rule's dispute and appeals right serves as a substitute in the case of an owner). HUD feels that the legal interests that should be protected by guaranteed access to a specific administrative dispute/appeal procedure are those of the project owner who may end up in mortgage default if the mortgage is not restructured and future section 8 project-based assistance is decreased or denied. This is in keeping with MAHRA.

HUD will, of course, be open to further discussion with a PAE if a PAE is convinced that rejection of a particular proposed Restructuring Plan is not in the best interests of the project or the public, and that the Plan cannot be modified to respond to HUD's objections. The Operating Procedures Guide provides a 10-day PAE comment period for this purpose, but HUD reserves the right to modify or dispense with this procedure in the future without rulemaking.

3. Time for owner to dispute approved plan.

One commenter said that an owner needs more than 10 days to decide how to respond to an approved Restructuring Plan under § 401.405, and suggested 30 days.

HUD response: Owners will receive a draft of the Restructuring Plan at least 10 days before the Plan is given to HUD for review and will have the Plan to review throughout HUD's review period. Accordingly, the additional 10-day period for owners to review the Plan after HUD approval provides ample time for thorough owner review.

4. Owner appeals.

One commenter felt that the administrative appeals procedure in the interim rule was ''sorely'' lacking in due process and said that it was unreasonable to limit review of adverse decisions to an informal review, given the possible severe economic consequences of such decisions. The commenter suggested using HUD's established procedures for dealing with administrative appeals. The other commenter suggested requiring that the official conducting the appeal should be knowledgeable about the Mark-to-Market program. This commenter also suggested that the official conducting the appeal should not be involved in any adverse action with the affected owner, in order to avoid a conflict of interest.

HUD response: The appeals procedure strikes a balance between the need for expeditious resolution of cases and the need to provide substantial notice and opportunity to be heard. The procedures detailed in the final rule provide adequate protection for owners. The final rule requires notice and an opportunity to be heard, and an appeal right in the event of an unfavorable decision. All cases will be handled carefully by knowledgeable and responsible OMHAR officials.

V. Section 401.600, Will a Section 8 Contract Be Extended if It Would Expire While an Owner's Request for a Restructuring Plan Is Pending?

Summary of Section

Under § 401.600, an owner who has requested development of a Restructuring Plan may receive a section 8 contract extension at current rents for the shortest reasonable period needed for the PAE to complete a Restructuring Plan for the project. Any extension of the contract beyond 1 year pending closing on the Restructuring Plan would be at comparable market rents or exception rents.

Summary of Comments

One commenter said that a delay in restructuring due to reasons outside the control of an owner should not lead to rent reduction. Another warned about the need to be sensitive to tenant displacement difficulties, saying that HUD should extend or renew a contract during any administrative appeal period for a determination of ineligibility and for long enough for vouchers to be issued.

HUD response: Delays in the restructuring process (unless clearly the result of a lack of cooperation by the owner) will not lead to a rent reduction prior to 12 months. Regardless of the cause of delay, the rents will in every case be reduced after 12 months, though

the project will remain eligible to continue with the restructuring. (OMHAR will consider a waiver if assignment of a project to a PAE was delayed through no fault of the owner.) We note that the restructuring process will begin at least 90 days prior to the original expiration and we urge owners concerned about this issue to exercise their option of entering the program early. HUD is sensitive to tenant displacement issues and will provide tenant vouchers in a timely manner.

W. Miscellaneous Comments on Part 401

The following miscellaneous comments on part 401 were made by at least one commenter:

1. When do contract rents need to be adjusted under a Restructuring Plan when an owner applies in advance of the contact expiration date?

HUD response: The contract rents would be adjusted upon restructuring.

2. Can Mark-to-Market restructuring use a structure from the Portfolio Reengineering demonstration programs under which short-term tax-exempt bonds were amortized through ''excess'' section 8 rents prior to expiration of existing contract?

HUD response: This will be addressed in a revision to the Operating Procedures Guide. The structure is likely to be acceptable for cases in which the expiration date is after the termination date of the Mark-to-Market Program.

3. Any ''guidance'' that may lead to ineligibility if not followed should be in the rule—and to the extent matters are not included in the rule, HUD must acknowledge that guidance is non-binding.

HUD response: The Operating Procedures Guide will be used as a vehicle for explaining and elaborating upon the detailed application of substantive requirements in the final rule, as well as addressing procedural and organizational matters that are not required to be included in regulations. The Guide will not be a means of introducing new substantive requirements that are properly the subject of a regulation.

4. HUD must give priority to affordable housing built in suburbs that expands fair housing choice.

HUD response: The PAEs are responsible for balancing the competing social and financial objectives in the Restructuring Plan for each of the projects assigned in their respective PRAs, regardless of location.

5. HUD needs to repeat more of MAHRA's language instead of cross-referencing (one commenter specifically mentioned § 401.420, while three mentioned § 401.421(b)).

HUD response: As part of our continuing effort to streamline rules, HUD's general approach to drafting rules now concentrates on the additional policy guidance needed to fill the gaps in matters expressly covered by statutory language, while minimizing repetition of statutory language that is already clear and that is not amplified in a rule. In response to these concerns of commenters, however, we carefully reviewed the places where the interim rule referenced statutory language to reconsider whether there would any benefit of added clarity or readability that would outweigh the disadvantage of more language added to an already long and complex rule. As a result of this review, we have added more of the statutory language in §§ 401.411(b), 401.420(a) and 401.421(b).

6. Lenders should be compensated for restructuring expenses and time and should be considered compensable third parties under section 517(b)(5) of MAHRA.

HUD response: Lenders may charge the owners reasonable fees for agreeing to modify existing first mortgages. Reasonable and customary loan origination fees may be recognized to the extent they are supported in the amount of a new refinancing loan (as opposed to a modificiation of the existing first mortgage).

7. The Paperwork Reduction Act burden-hour estimates are low.

HUD response: We have reconsidered these estimates and have revised them accordingly. We will pursue approval of our revised estimates through established procedures.

8. FHA's allowable servicing fees should be raised because the size of first mortgage will go down through restructuring.

HUD response: FHA servicing fees are not governed by this final rule.

III. Changes Made to Part 401 of Interim Rule

References are to the section number of the interim rule.

401.1 What Is the Purpose of Part 401?

We removed a sentence that stated that part 401 contains the regulations for the renewal of project-based assistance for eligible projects without restructuring under the Mark-to-Market Program, to recognize that § 401.601 (regarding the ''OMHAR Lite'' procedure) has been redesignated as § 402.4(a)(2).

401.2 What Special Definitions Apply to This Part?

- In the definition of eligible project, we added material from § 401.100 of the interim rule, which was titled ''Which projects are eligible for a Restructuring Plan under this part?'' This avoids duplication, and recognizes that the term ''eligible project'' is used in parts 401 and 402 in a manner that is intended to include the provisions that were in § 401.100 of the interim rule. Section 401.100 is removed in the final rule. We also added that an eligible project must have a first mortgage that has not been restructured under part 401 or under a demonstration program to reflect our understanding of statutory intent.

Some projects under demonstration programs received restructuring of rents to budget-based levels without debt restructuring. Under HUD's interpretation of MAHRA as originlly enacted, all such projects were eligible for Mark-to-Market restructuring, while projects with debt restructured under the demonstration programs were exeption projects. Section 531(b) of Pub. L. 106–74 amended MAHRA to exclude from eligible projects all demonstration projects for which HUD ''determines that rent restructuring is inappropriate''. No change to the rule language is needed to accomplish this result, since the language as drafted automatically picks up the relevant statutory change. (The same is true of preservation projects described in section 531(b)). Similarly, section 531(c) of the new law has the effect under current rule language of automatically including some State-financed projects (those with FHA insurance and an absence of conflict between debt restructuring and applicable State law or financing agreements) as intended by Congress.

- In the definition of priority purchaser, we clarified that a general partnership with a sole general partner that itself is a priority purchaser will be regarded as a priority purchaser.
- We added a definition of OMHAR.
- We defined voucher to mean any tenant-based assistance (as defined in section 8(f) of the United States Housing Act of 1937; see section 512(15) of MAHRA)). This definition was added to make clear that use of the term voucher in the final rule, in contexts where the interim rule referred to vouchers and certificates, is a non-substantive change that reflects the statutory merger of the section 8 voucher and certificate programs.
- We added a new paragraph (d) referencing other definitions in the

conflict of interest sections of the final rule.

401.3 Who May Waive Provisions in This Part?

This section, not in the interim rule, clarifies that waivers of part 401 are made by the Director of OMHAR subject to the HUD regulations implementing section 106 of the HUD Reform Act of 1989. Ordinarily the Secretary delegates both the authority to waive and issue rules to the Assistant Secretary or equivalent responsible for administering a program. Because the OMHAR Director's authority to issue part 401 derives directly from statute, rather than from authority delegated by the Secretary, this section is advisable to clarify that the OMHAR Director's statutory authority to issue rules encompasses the power to waive them. The section implements an interpretation that OMHAR rules are ''regulations of the Department'' within the meaning of section 106, so that a waiver must be in writing, state the grounds for the waiver, and be included in the Secretary's periodic **Federal Register** notice of waivers.

401.99 How Does an Owner Request a Section 8 Contract Renewal? [Revised Title]

We removed the interim provision that permitted an owner to submit a request for contract renewal less than 90 days before the contract expiration date if that date was before January 13, 1999. That provision is no longer needed. We added language recognizing that an owner eligible to request renewal under § 402.5 may instead request renewal under § 402.4. We removed language that duplicated § 402.6 for owners of eligible projects seeking renewal without a Restructuring Plan, and substituted a cross-reference to § 402.6. We removed a reference to affiliates due to a change to § 401.101.

Finally, the final rule requires the owner to certify that neither it nor an affiliate has received notice from HUD of a pending suspension, debarment or other enforcement action (unless voluntary sale or transfer is proposed). If the owner is unable to make this certification but does not consider that the subject of the pending suspension or debarment action is grounds for rejection under the standards of section 516 of MAHRA, the owner should submit the rest of the certification with an explanation of the disagreement. HUD will consider this explanation when determining whether to exercise its discretion to reject a request under § 401.101 (revised as discussed below). The final rule thus does not require HUD to accept a request for restructuring if HUD expects to immediately reject the application under § 401.403 based on information about the owner or an affiliate that HUD has already developed. In many cases it will be more efficient to address a problem with an owner or affiliate at the earliest possible stage, so that other approaches (such as project sale) can be explored promptly. Later rejection under § 401.403 could still be possible if review under § 401.101 does not lead to immediate rejection. Owners have the same appeal and dispute rights whether rejection is under § 401.101 or § 401.403 and thus are not adversely affected by this refinement in the final rule.

401.100 Which Projects Are Eligible for a Restructuring Plan Under this Part?

We removed this section and combined it with the definition of ''eligible project'' in § 401.2(c).

401.101 Which Owners Are Ineligible To Request a Restructuring Plan? [Revised Title]

As explained above, if there is a pending HUD enforcement action against the owner or an affiliate that is based on an action that is grounds for rejection under section 516 of MAHRA, HUD may decide initially not to accept a request for restructuring instead of waiting to reject the request under § 401.403. We added a sentence to § 401.101 to clarify this point. We also revised this section so that rejection of an owner is no longer always required when an affiliate of the owner, but not the owner itself, has already been debarred or suspended. Rejection in that situation will be discretionary with HUD, based on a consideration of the specific facts and circumstances. We made the same change to section 401.403.

401.200 Who May Be a PAE?

Although we have retained the requirement that each non-public PAE must form a partnership with a public purpose entity, as required by section 513(b)(7)(A) of MAHRA, we have omitted the requirement that such a partnership meet all legal requirements for a partnership. This will provide some flexibility to accommodate legal limitations that may restrict some public purpose entities from entering into an arrangement that qualifies as a partnership under applicable State law, if the arrangement otherwise meets the purposes of this requirement of MAHRA. HUD will assist individual non-public PAEs as needed in determining whether their proposed partnership arrangement meets the requirements of MAHRA and this section of the final rule.

401.300 What Is a PRA?

New language recognizes that a PRA may incorporate by reference certain required matters that are adequately addressed in other documents.

401.301 Partnership Arrangements [Revised Title]

The revised title describes the subject of this section more precisely.

401.304 PRA Provisions on PAE Compensation

In the preamble to the interim rule, HUD stated its intention to include more specific provisions on PAE compensation in the final rule, after negotiating arrangements for the initial PAEs and refining the precise duties of PAEs in the initial PRA development process. The final rule contains some additions to § 401.304 based on experience to date. Regarding base fees, HUD will use an annual survey of the market price for the work to determine compensation for public PAEs, and a competitive bid process to determine fees for private PAEs. HUD will set a uniform per-project base fee for each public PAE. The individual components of incentive packages may vary, but the total per-project incentive payment will be uniform for all PAEs, whether public or private. HUD will establish annual limits for reimbursement of expenses for each project, with the possibility of waivers for high-cost areas. The Director of OMHAR must approve all fee schedules. OMHAR's Internet website will contain the standard form of PRA and compensation package, with annual updating.

401.307 On-Going Responsibility of PAE

We have deleted this section because it did not add any specific substantive requirement. This subject is addressed in an expanded subpart D in the final rule.

401.309 PRA Term and Termination Provisions; Other Remedies

We have added an express provision for termination of the PRA for the convenience of the Federal Government similar to the standard arrangement used when the Federal Government contracts for procurement of services. Although the PRA is not a procurement contract, the underlying need of the Federal Government for a termination for convenience provision is also present for a PRA. The termination for convenience provision was generally authorized by § 401.300 of the interim

rule that provided for a PRA to contain ''other terms and conditions required by HUD'' but HUD is choosing to address the matter expressly in the final rule.

401.310 Conflicts of Interest

We narrowed the provision in paragraph (a)(1)(i) on PAE financial interests to focus more precisely on likely areas of conflict. We added language to paragraph (d)(1)(ii) to clarify that a potential PAE that notifies HUD, after a request for selection but before selection, of a conflict of interest must provide a detailed description of the conflict.

401.312 Confidentiality of Information

We added language recognizing that the tenant/community participation procedures in §§ 401.500 through 401.503 of the final rule require some exceptions to the PAE's general obligation to safeguard confidential project and owner information.

401.313 Consequences of PAE Violations; Finality of HUD Determination

We have simplified the language regarding liability of PAEs to HUD for damages resulting from violations of the rules on conflicts of interest, standards of conduct and confidentiality of information. We made several minor editorial changes.

401.314 Environmental Review Responsibilities

The interim rule requires HUD to complete any required environmental review under 24 CFR part 50 before HUD executes a Restructuring Commitment. The final rule clarifies that HUD will complete all actions required for compliance with part 50 (including consideration of any environmental review and consideration of rejection or modification based on any adverse environmental impacts) before HUD executes a Restructuring Commitment.

401.402 Cooperation With Owner and Qualified Mortgagee in Restructuring Plan Development

We added language to clarify that owner cooperation will be demonstrated by reasonable progress in development of a Restructuring Plan.

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

We added language to clarify that HUD and the PAE will refuse to consider restructuring when the current owner is ineligible, because of debarment or suspension or for other reasons that result in a discretionary determination of ineligibility, unless the owner proposes to sell or transfer the property to an eligible purchaser. Also, we added language clarifying that rejection under section 516(a)(4) of MAHRA and this section due to poor condition of the project may be under § 401.451(c) or otherwise. Section 401.451(c) provides an early formal step, upon completion of the Physical Condition Analysis for the project, at which the PAE must consider whether continuing with rehabilitation through a Restructuring Plan will be a cost-effective means of ensuring affordable housing for the tenants. HUD and the PAE will continue to have the right to reject a project in poor condition even if it is not rejected at this early stage. For example, tenant and community input might lead HUD or the PAE to consider the matter further. Finally, we made a change regarding rejection based on suspension or debarment of an affiliate of the owner that is explained in the discussion above under section 401.101, where the same change was made.

401.404 Proposed Restructuring Commitment

The final rule adds a reference to the public meeting required by § 401.500(c) of the final rule. That meeting must be held at least 10 days before the Restructuring Plan and proposed Restructuring Commitment are submitted to HUD under this section. We also specify in the final rule that the Restructuring Commitment must state all consideration that the PAE or related parties receives other than from HUD, in order to identify for OMHAR an area of potential bias or conflict of interest.

401.405 Restructuring Commitment Review and Approval by HUD

New language in the final rule makes it clear that a PAE must inform the owner when HUD rejects a Restructuring Commitment proposed by the PRA, so that the owner can decide whether to dispute the rejection under the subpart F procedures.

401.408 Affordability and Use Restrictions Required

Under new paragraph (e) of the final rule, the recorded Use Agreement must require that the owner comply with § 401.556 of the final rule (§ 401.483 of the interim rule) regarding nondiscrimination against voucher holders in leasing. Under new paragraph (f) of the final rule, the Use Agreement must contain remedies for a breach of the Use Agreement. The remedies must include monetary damages for non-compliance with the affordability restrictions or the physical condition standards in § 401.558 of the final rule. Under new paragraph (g) of the final rule, the Use Agreement must contain a requirement for maintaining the property in compliance with the physical condition standards.

We made a technical change to paragraph (a) to reflect the movement of paragraph (e) of the interim rule (now paragraph (k) of the final rule) and the addition of new paragraphs. These changes clarify that an owner's obligation to renew project-based assistance is not a matter for the recorded Use Agreement, but derives directly from MAHRA and this rule and will be implemented by a rider to the section 8 HAP contract. In what is now paragraph (i), we clarified that the listed interested parties will have rights to enforce the Use Agreement (subject to modification as previously discussed) with the possibility that a particular Use Agreement could specify additional enforcing parties, and added a requirement for the enforcing party to give the owner notice and a reasonable opportunity to cure any violations. In what is now paragraph (j), the final rule requires the owner to post on project property notice of any modifications to the Use Agreement approved by HUD. In what is now paragraph (k), we removed a reference to owner acceptance of tenant-based assistance because it was inaccurate. (Note that new § 401.554 accurately describes the availability of tenant-based assistance required by a Restructuring Plan, consistent with section 515(a)(2) of MAHRA.)

401.410 Standards for Determining Comparable Market Rents

In paragraph (a)(1), we clarified that the MAHRA comparable market rent standard only applies to project-based assistance. Any tenant-based assistance provided under a Restructuring Plan will be subject to the similar ''rent reasonableness'' standard of section 8(o)(10)(A) of the United State Housing Act of 1937, which applies both to enhanced and regular vouchers. We clarified that section 202/811 projects are not comparable properties for purposes of determining market comparable rents.

We added general language permitting the PAE to make appropriate adjustments when needed to ensure comparison of comparable through comparison with comparable properties. Examples of appropriate adjustments would be adjustments needed due to the non-luxury standard for Mark-to-Market projects (as discussed in the interim rule

preamble) and adjustments needed for utility allowances or to reflect the value of any non-section 8 subsidy provided to the project with the expiring section 8 contract (as mentioned in new section 524(a)(5) of MAHRA). This section is also incorporated into part 402 and applied to projects that are not undergoing debt restructuring. For such projects, the references to the PAE should be treated as references to HUD.

401.411 Guidelines for Determining Exception Rents

We have included some statutory text that was cross-referenced in the interim rule, clarified that exception rents only apply to project-based assistance.

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

We clarified that under this rule OCAF applies only to project-based assistance. We removed the reference to negative OCAF. We redesignated paragraphs (a) and (b) of the interim rule as paragraphs (a)(1) and (a)(2) and added a new paragraph (b) explaining the availability of budget-based adjustments upon request of the owner, subject to the approval of the Secretary, as provided in Pub. L. 106–74.

401.420 When Must the Restructuring Plan Require Project-Based Assistance?

We have included some statutory text that was cross-referenced in the interim rule.

401.421 Rental Assistance Assessment Plan

We have included some statutory text that was cross-referenced in the interim rule.

401.450 Owner Evaluation of Physical Condition

In paragraph (a)(1), we clarified that the owner's list of work items needed to bring the project to the property standard for rehabilitation that is stated in the rule and MAHRA (non-luxury standard adequate for the rental market for which the project was originally approved) should include any work items needed to ensure compliance with applicable requirements of 24 CFR part 8 concerning accessibility to persons with disabilities. The interim and final rules permit rehabilitation to include improvements to meet current standards if the non-luxury standard has changed over time. Accessibility measures are an example of how standards have evolved since original project approval. The addition to paragraph (a)(1) is consistent with § 401.452, which makes it clear that there is no exemption from applicable part 8 requirements simply because rehabilitation is through the Mark-to-Market Program.

We added a new paragraph (b) permitting the owner to submit an up-to-date Comprehensive Needs Assessment (CA) in place of a new evaluation, if all requirements of paragraph (a) are met. Cans must be prepared following procedures outlined in HUD Notice H 97–02 or in subsequent administrative guidance from HUD.

401.451 PAE Physical Condition Analysis (PCA)

We have revised the heading of paragraph (c) to emphasize that it permits rejection of projects in such poor condition that restructuring with rehabilitation is not a cost-effective way of continuing to ensure affordable housing for tenants, as provided in section 516(a)(4) of MAHRA. We added language clarifying that a PAE can only recommend rejection, with HUD making the final decision.

401.452 Property Standards for Rehabilitation

We added an express requirement for the PAE to consider marketability when planning rehabilitation.

401.453 Reserves [New Title]

Because paragraph (a) of this section of the interim rule contains the standards that must be maintained while the Restructuring Plan is in effect, we moved it to subpart D (''Implementation of the Restructuring Plan After Closing''). It is § 401.558 in the final rule under a revised title. We revised the title of this section to reflect its narrowed scope in the final rule.

401.460 Modification or Refinancing of First Mortgage

We added language to paragraph (e) to require the owner to discuss mortgage modification with the existing first mortgagee before considering other sources of first mortgage financing under the Restructuring Plan. We also added language to paragraph (a) to clarify that the size of the first mortgage and monthly payments may not increase through mortgage modification but may increase through refinancing (*e.g.,* a refinancing mortgage that includes rehabilitation financing). Finally, the final rule acknowledges section 219 of Pub.L. 106–74, which gives priority to risk-sharing financing in a Restructuring Plan if it is the best available financing in terms of financial savings and will reduce the Federal Government's risk of loss.

401.461 HUD-Held Second Mortgage

We reorganized paragraph (a) and added language on the following points:

- To clarify that HUD may allow a PAE to negotiate an additional (*e.g.,* third) mortgage for less than the maximum amount permitted by the final rule. Additional guidance for PAEs is included in the Operating Procedures Guide.
- To clarify the owner's right to appeal acceleration of the second mortgage does not apply when acceleration is pursuant to grounds for acceleration that are specified in section 517(a)(4)(A) and (B) of MAHRA, since they do not involve the type of complex legal or factual questions for which an administrative appeals procedure may help to avoid unnecessary litigation. (The grounds are termination or payment in full of the first mortgage and unauthorized project sale/second mortgage assumption.)
- To clarify that, upon payment of the second mortgage in full, any additional (*i.e.,* third) mortgage under this section is not automatically accelerated but is then payable upon demand by HUD or as otherwise agreed by HUD (*e.g.,* under an approved payment schedule).
- To recognize circumstances under which the new HUD-held mortgage may be a first mortgage, in response to sec. 213 of Pub.L. 106–74.

401.472 Rehabilitation Funding

We have included in the final rule a requirement that appeared only in the preamble for the interim rule: That the owner contribution include a reasonable proportion of the rehabilitation cost from nongovernmental resources. HUD will provide additional guidance in the Operating Procedures Guide regarding standards for determining a ''reasonable proportion''.

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

The final rule inserts language that was inadvertently omitted during printing of the interim rule. As printed, the interim rule permitted delegation of grant administration responsibility only if grant funding were available to pay for grant administration. Nothing in section 236(s)(5)(A) of the National Housing Act prevents a PAE from agreeing to accept delegation without reimbursement of costs. HUD did not intend to prevent it by regulation.

401.474 Project Accounts

We added language to paragraph (b) to clarify that it is the actual release of funds to the owner under this section that must be delayed until after

completion of rehabilitation, not the determination of the amount of funds to be released.

401.480 Sale or Transfer of Project [Revised Title]

We have removed ''voluntary'' from the title of this section because it was potentially misleading. Although all projects sales will be voluntary in the sense that owners must agree to them, some project sales may be considered involuntary in the sense that no Restructuring Plan will be approved under current project ownership. We have also revised the section to clarify that purchasers defined in the rule as ''priority purchasers'' do not have a right to priority consideration for involuntary sales indefinitely, but only for a reasonable period that OMHAR will determine. By definition, priority purchasers will have tenant support. The final rule clarifies that other purchasers will also be required to provide evidence of tenant support.

401.481 Subsidy Layering Limitations on HUD Funds

Additional language clarifies that the subsidy layering certification does not preclude a Restructuring Plan that includes project reconfiguration needed to meet the needs of the community.

401.483 Leasing Units to Voucher Holders

Because this section concerns leasing of units while the Restructuring Plan is in effect, we moved it to Subpart D (''Implementation of the Restructuring Plan After Closing''). It is § 401.556 in the final rule.

401.484 Property Management Standards

Because this section concerns property management standards while the Restructuring Plan is in effect, we also moved it to Subpart D. It is § 401.560 in the final rule.

401.500 Required Notices to Third Parties and Meetings With Third Parties [Revised Title]

In paragraph (b)(2) of the final rule, notice of the initial public meeting is now required no more than 40 days before the meeting, instead of 60 days as in the interim rule. New paragraphs (c) and (d) cover a new requirement for public notice and comment on a substantively completed Restructuring Plan before the PAE submits the Plan to OMHAR. A second public meeting is also now required by new paragraph (d).

New paragraph (f) (a revision of paragraph (c) of the interim rule) ensures that the PAE will document and provide to HUD all public comments on the proposed Restructuring Plan. Paragraph (f) clarifies that notice is required whenever the PAE determines that the Restructuring Plan will not move forward, for any reason, after the owner has requested that a Plan be developed or after a Plan is determined to be necessary under § 402.4(a)(2). The interim rule language was ambigous on whether notice was required in the absence of an OMHAR rejection. As revised, the final rule notice requirement also applies whenever an owner does not take the necessary actions to complete the restructuring process, including withdrawal of the request to restructure or failure to execute an approved Restructuring Commitment.

401.501 Delivery of Notices and Recipients of Notices [Revised Title]

The final rule requires notice to tenants and tenant organizations, directly and through posting, instead of permitting notice to a tenant organization alone to suffice as tenant notice as under the interim rule. Notice also must now be given to the ITAG and OTAG grantees serving the jurisdiction in which the property is located.

401.502 Notice Requirement When Debt Restructuring Will Not Occur

This new section provides that persons who would have received notice of a Restructuring Plan request under §§ 401.500–.501 will receive notice if the owner of an eligible project requests section 8 contract renewals without debt restructuring. HUD or the PAE must make publicly available basic project identified in § 401.500(b)(1)(i), (ii) and (iv), and the Owner Evaluation of Physical Condition and comparative market rent analysis that are required in connection with the renewal request (without expense or profit/loss information). The PAE must announce a procedure to accept public comments on this information. The PAE must consider the comments and document the consideration for HUD.

401.503 Access to Information

This new section explicitly recognizes that a PAE, in fulfilling its responsibilities to provide for tenant and community participating in developing a Restructuring Plan, will need to make available information about the project and the owner. In general, the PAE is not expected to make public confidential or proprietary information obtained from the owner. This section does require the PAE to make public the Owner Evaluation of Physical Condition and the owner-prepared 1-year project rent analysis (without expense or profit/loss information) even if the owner asserts confidentiality/proprietary rights. The PAE is never required to disclose expense, property valuation, or profit/loss information without owner consent.

401.550 Monitoring and Compliance Agreements

This section requires PAE inspections of projects that have undergone restructuring in accordance with section 519(b)(2) of MAHRA, subject to HUD's uniform inspections procedures in 24 CFR part 5, subpart G. To avoid duplicative inspections under such procedures (such as by the mortgagee if the mortgage continues to be insured, as provided in 24 CFR 207.260), the final rule adds a clarification that HUD will accept an inspection by a PAE that complies with the uniform inspection procedures in lieu of an inspection under those procedures required by any other party. We have also added a sentence to make explicit what was implicit in the interim rule—that the provisions of subpart D apply as long as the Use Agreement is in effect. Finally, we added a new paragraph (d) to this section requiring HUD to regulate the mortgagor through a regulatory agreement as long the Secretary holds the second or additional (third) mortgage under this rule. This would be in addition to any regulatory agreement required in connection with FHA mortgage insurance.

401.554 Contract Renewal and Administration [Revised Title]

We added language corresponding to section 515(a) of MAHRA, under which HUD or a public body PAE designated as contract administrator must offer to renew section 8 contracts as provided in a Restructuring Plan, subject to the availability of appropriations and subject to the renewal authority available at the time of each contract expiration. Section 524 of MAHRA (as amended by Pub. L. 106–74) will be the renewal authority.

401.556 Leasing Units to Voucher Holders

This redesignated section was § 401.483 of the interim rule under a slightly different title.

401.558 Physical Condition Standards

This redesignated section was § 401.453(a) of the interim rule under a different title. We removed language regarding duration of the requirement in the section because it duplicates new language added to § 401.550 in the final rule.

401.560 Property Management Standards

This redesignated section was § 401.484 of the interim rule.

Subpart E—Section 8 Requirements for Restructured Projects

401.595 Contract and Regulatory Provisions

Section 401.607 of the interim rule is combined with this section of the final rule. The section is expressly limited to project-based assistance because the scope is intended to be identical with § 402.3.

401.600 Will a Section 8 Contract Be Extended if It Would Expire While an Owner's Request for a Restructuring Plan Is Pending?

In the preamble to the interim rule, HUD indicated that it would typically exercise its discretion under this section to provide a contract extension at existing rents for up to 1 year by initially providing an extension of no more than 9 months. Upon further consideration, HUD currently expects to initially extend a contract at existing rents for 1 year, subject to the rule provision permitting contract termination for an owner who is uncooperative or who is rejected for Mark-to-Market restructuring. We expect to make an exception for an owner that executed a Restructuring Commitment under a demonstration program but failed to proceed. Although such an owner is eligible to request a Restructuring Plan under part 401 and a contract extension under this section, the owner will usually be given an extension at existing rents for a period that is substantially shorter than a full additional year. There is no change in the actual rule language for this section.

401.601 Consideration of an Owner's Request To Renew an Expiring Contract for an Eligible Project Without a Restructuring Plan

We redesignated this section as § 402.4(a)(2) but made no substantive revisions except as follows. We added language that ensures that a HUD or a PAE will take into account tenant and community comments received under new § 401.502 about whether contract renewal without a Restructuring Plan would be sufficient to maintain both adequate debt service coverage and necessary replacement reserves. The final rule also makes it clear that HUD, not the PAE, will make the final decision to require a Restructuring Plan. A conforming change was made to § 402.1 to reflect the section redesignation.

401.602 Tenant Protection if an Expiring Contract Is Not Renewed

Paragraphs (a) and (b) of this section have been amended to reflect changes in the underlying statutory provisions. Specifically, Pub. L. 105–276 repealed a notice requirement of former section 8(c)(8) of the United States Housing Act of 1937, and corresponding provisions of the interim rule have therefore been removed. The notice requirement of former section 8(c)(9) of the 1937 Act (now redesignated as section 8(c)(8)) was amended by both Pub. L. 105–276 and Pub. L. 106–74, so that corresponding changes have been made in the corresponding interim rule provisions of this section. Also, Pub. L. 105–276 added an additional 120-day notice requirement for contract terminations by owner who chose to pursue restructuring, with restrictions on rent increase and evictions during the notice period, and this section of the final rule reflects those provisions.

We also added language in paragraph (a) specifying that required notice to HUD is to be sent instead to the contract administrator if there is one, reflecting established practice. We made a change to clarify that an owner cannot give notice under paragraph (a) while simultaneously pursuing a Restructuring Plan and contract renewal.

We added language to paragraph (c) to clarify two points: (1) HUD's statutory obligation to make tenant-based assistance available in certain circumstances described in paragraphs (c)(1) and (c)(2) (corresponding to sections 514(d) and 516(d) of MAHRA) is subject to the usual eligibility requirements in the tenant-based assistance program regulations, and (2) tenant-based assistance is available pursuant to this section only when project-based assistance is not renewed. Pub. L. 106–74 provides for enhanced vouchers to certain tenants when project-based assistance is not continued, and this is reflected in a revision to paragragh (c).

We added cross-references to rejection under § 401.451 for poor project condition to supplement existing cross-references to rejection for that reason under § 401.403. Finally, we deleted a sentence of § 401.602(b) of the interim rule that stated that the period during which rents may not be raised begins on the earlier of the date of actual notice to tenants or the date of contract expiration. HUD's intent in including this language in the interim rule was to provide an express regulatory basis for language restricting rent increases that had previously been included in contracts to implement statutory notification requirements. However, the sentence being deleted went beyond what has been stated in actual contract language and thus was not necessary to accomplish HUD's intent. In addition, the sentence being deleted may be inconsistent with the new statutory 120-day notice requirement mentioned above. The amendment to section 514(d) of MAHRA adding the 120-day notice specifically addresses the rent increase question, as follows: If the notice is not provided, ''the owner may not evict the tenants or increase the tenants'' rent payment until such time as the owner has provided the 120-day notice and such period has elapsed.'' This appears to require both actual notice and passage of time before an owner may increase rents.

401.605 Project-Based Assistance Provisions

We added language to clarify that this section applies to the initial rents upon restructuring and not to subsequent contract renewals.

401.606 Tenant-Based Assistance Provisions

We added language similar to the addition to § 401.602(c) described above regarding eligibility under tenant-based assistance program regulations. We also revised the second sentence to conform to section 538 of Pub. L. 106–74 of enhanced vouchers.

401.607 Contract Term

This section of the interim rule is removed and its language is added to § 401.595 of the final rule.

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

We made a conforming change to reflect the change to § 401.461(b)(4) regarding appeal of acceleration of the second mortgage.

401.651 Appeal Procedures

We added language to paragraph (c) to clarify that a HUD official is disqualified from considering an appeal only of a matter that the official (or someone the official reports to) was directly involved in, not every matter that falls within the official's general area of responsibility.

IV. Findings and Certifications

Paperwork Reduction Act

The information collection requirements contained in this rule have been approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–

3520) and assigned OMB approval number 2502–0531. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

Environmental Impact

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

Executive Order 12866

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

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

Regulatory Flexibility Act

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

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

Some of the Participating Administrative Entities (PAEs) selected under the final rule, such as nonprofit organizations and for-profit entities, may be small entities. In the final rule HUD has chosen to preserve for the PAE substantial discretion, within the limits of the statute, to choose the most cost-effective way of undertaking the mortgage restructuring of projects assigned to the PAE. No more projects will be assigned to a PAE than a PAE is able and willing to deal with. Each nonprofit and for-profit PAE will partner with a public entity to provide additional resources and reduce the burden of undertaking restructuring. Nothing in the final rule imposes a disproportionate burden on a small entity.

Executive Order 13132, Federalism

This final 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.

Unfunded Mandates Reform Act

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

List of Subjects

24 CFR Part 401

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

24 CFR Part 402

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

For the reasons set forth in the preamble, 24 CFR Chapter IV is amended to read as follows:

1. The chapter heading is revised to read as follows:

CHAPTER IV—OFFICE OF HOUSING AND OFFICE OF MULTIFAMILY HOUSING ASSISTANCE RESTRUCTURING, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

2. Part 401 is revised to read as follows:

PART 401— MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING PROGRAM (MARK-TO-MARKET)

Subpart A—General Provisions; Eligibility

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

Subpart C—Restructuring Plan

Subpart D—Implementation of the Restructuring Plan after Closing

Subpart E—Section 8 Requirements for Restructured Projects

Subpart F—Owner Dispute of Rejection and Administrative Appeal

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

Subpart A—General Provisions; Eligibility

§ 401.1 What is the purpose of part 401?

This part contains the regulations implementing the authority in the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) for the Mark-to-Market Program. Section 511(b) of MAHRA details the purposes, and section 512(2) details the scope, of the Program.

§ 401.2 What special definitions apply to this part?

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

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

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

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

Applicable Federal rate has the meaning given in section 1274(d) of the Internal Revenue Code of 1986, 26 U.S.C. 1274(d).

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

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

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

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

Eligible project means a project that:

(1) Has a mortgage insured or held by HUD;

(2) Receives project-based assistance expiring on or after October 1, 1998;

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

(4) Has a first mortgage that has not previously been restructured under this part or under a Reengineering demonstration program;

(5) Is not described in section 514(h) of MAHRA; and

(6) Otherwise meets the definition of ''eligible multifamily housing project'' in section 512(2) of MAHRA.

HUD means the Director of OMHAR or a HUD official authorized to act in lieu of the Director, when used in reference to provisions of MAHRA that give responsibilities to the Director, and otherwise has the meaning given in § 5.100 of this title.

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

OMHAR means the Office of Multifamily Housing Assistance Restructuring.

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

PAE means a participating administrative entity as defined in section 512(10) of MAHRA, or HUD

when appropriate in accordance with section 513(b)(4) of MAHRA.

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

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

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

(1) A tenant organization;

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

(3) A limited partnership with a sole general partner that itself is a priority purchaser under this definition.

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

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

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

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

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

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

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

Voucher means any tenant-based assistance.

(d) *Conflicts of interest.* Additional definitions applicable to §§ 401.310 through 401.313 appear in § 401.310.

§ 401.3 Who may waive provisions in this part?

The Director of OMHAR may waive any provision of this part, subject to § 5.110 of this title.

§ 401.99 How does an owner request a section 8 contract renewal?

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

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

(2) The owner is not suspended or debarred or has been notified by HUD of any pending suspension or debarment or other enforcement action, or, if so, a voluntary sale transfer of the property is proposed in accordance with § 401.480.

(b) *Eligible but not requesting Restructuring Plan.* If an owner is eligible for a Restructuring Plan but requests a renewal of project-based assistance without a Plan, in accordance with the applicable requirements in § 402.6 of this chapter, HUD will consider the request in accordance with § 402.4(a)(2) of this chapter.

(c) *Not eligible for Restructuring Plan.* Section 402.5 of this chapter addresses renewal of project-based assistance for a project not eligible for a Restructuring Plan. An owner of such a project may also request renewal under § 402.4.

§ 401.101 Which owners are ineligible to request Restructuring Plans?

(a) *Mandatory rejection.* The request of an owner of an eligible project will not be considered for a Restructuring Plan if the owner is debarred or suspended under part 24 of this title.

(b) *Discretion to reject.* HUD may also decide not to accept a request for a Restructuring Plan if:

(1) An affiliate is debarred or suspended under part 24 of this title; or

(2) HUD notifies the owner that HUD is engaged in a pending suspension, debarment or other enforcement action against an owner or affiliate, and the grounds for the pending action are included in § 401.403(b)(2)(ii).

(c) *Exception for sale.* This section does not apply if a sale or transfer of the property is proposed in accordance with § 401.480.

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

§ 401.200 Who may be a PAE?

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

§ 401.201 How does HUD select PAEs?

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

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

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

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

§ 401.300 What is a PRA?

A PRA is an agreement between HUD and a PAE that delineates rights and responsibilities in connection with development and implementation of a Restructuring Plan. The PRA must contain or incorporate by reference the matters required by section 513(a)(2) of MAHRA and §§ 401.301 through 401.314, as well as other terms and conditions required by HUD.

§ 401.301 Partnership arrangements.

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

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

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

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

§ 401.302 PRA administrative requirements.

(a) *Inapplicability of certain requirements.* Parts 84 and 85 of this title and contract procurement requirements do not apply to a PRA.

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

(c) *Inspection of records and audit.* Upon reasonable notice, the PAE must

permit the Comptroller General of the United States and HUD (including representatives of the HUD Office of Inspector General) to inspect, audit, and copy any records required to be retained under this section.

§ 401.303 PRA indemnity provisions for SHFAs and HAs.

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

§ 401.304 PRA provisions on PAE compensation.

(a) *Base fee.* (1) The PRA will provide for base fees to be paid by HUD.

(2) HUD will conduct an annual survey of the market price for the scope of work. The results of each survey will be used to establish a uniform baseline for public entities. The base fee for a PAE will be adjusted if necessary after the first term of the PRA.

(3) Private PAEs will be compensated based on the results of a competitive bid process which evaluates bidders' capability, timeliness, ability to work with tenant and community groups, and cost.

(b) *Incentives.* The PRA may provide for incentives to be paid by HUD. While individual components may vary between PAEs (both public and private), the total amount payable under the incentive package will be uniform. Objectives will include maximizing savings to the Federal Government, timely performance, tenant satisfaction with the PAE's performance, the infusion of public funds from non-HUD sources, and other benchmarks that HUD considers appropriate.

(c) *Expenses.* The PRA will identify expenses incurred by the PAE that will qualify for reimbursement by HUD. Limits on these expenses will be established annually by HUD, but HUD may waive the limits for high-cost areas.

(d) *Other matters.* The Director of OMHAR will retain the right of final approval of any fee schedule on behalf of HUD. HUD will publish the standard form of PRA and the compensation package annually on its Internet website.

§ 401.309 PRA term and termination provisions; other remedies.

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

(b) *Termination for cause or convenience of Federal Government.* (1) *Termination for cause.* HUD may terminate a PRA at any time for cause, with payment required by HUD as provided in the PRA only for matters authorized by the PRA and performed by the PAE to the date of termination. HUD will retain the right of set-off against any payments due as well as such other rights afforded at law and in equity.

(2) *Termination for convenience of Federal Government.* HUD may terminate a PRA at any time in accordance with the PRA or applicable law regardless of whether the PAE is in default of any of its obligations under the PRA if such termination is in the best interests of the Federal Government. The PRA will provide for payment to the PAE of a specified percentage of the base fee authorized by § 401.304(a) and amounts for reimbursement of third-party vendors to the PAE authorized by § 401.304(c).

(3) *Transfer to another PAE; temporary waiver of rights.* If a PRA is terminated:

(i) HUD may order an immediate transfer of some or all of the PAE's duties to another PAE designated by HUD; and

(ii) HUD may temporarily waive its right of immediate termination in order to allow an orderly transfer of duties and responsibilities under a PRA, without waiving the right of termination after the transfer has been completed to HUD's satisfaction.

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

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

§ 401.310 Conflicts of interest.

(a) *Definitions.*—(1) *Conflict of interest* means a situation in which a PAE or other restricted person:

(i) Has a financial interest, direct or indirect, that prevents or may prevent the PAE or other restricted person from acting at all times in the best interests of HUD;

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

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

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

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

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

(2) The PAE must establish procedures to identify conflicts of interest and to ensure that conflicts of interest do not arise or continue, subject to waiver under paragraph (c) of this section.

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

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

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

(d) *Conflicts of interest arising prior to PAE selection.*—(1) *Request for review of conflicts of interest.* (i) A potential PAE, with its request to HUD for consideration for selection as a PAE,

must identify existing conflicts of interest and may make a written request for a determination as to the existence of a conflict of interest, may request that the conflict of interest, if any, be waived, or may propose how it could eliminate the conflict.

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

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

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

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

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

§ 401.311 Standards of conduct.

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

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

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

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

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

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

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

(d) *18 U.S.C. 207.* Former Federal Government employees are subject to the prohibitions in 18 U.S.C. 207.

§ 401.312 Confidentiality of information.

A PAE and every other restricted person (as defined in § 401.310) has a duty to protect confidential information, except as provided in §§ 401.500 through 401.503, and to prevent its use to further a private interest other than as contemplated by the PRA. As used in this section, confidential information means information that a PAE or other restricted person obtains from or on behalf of HUD or a third party in connection with a PRA but does not include information generally available to the public unless the information becomes available to the public as a result of unauthorized disclosure by the PAE or another restricted person.

§ 401.313 Consequences of PAE violations; finality of HUD determination.

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

(1) Find the potential PAE unqualified to enter into a PRA;

(2) Find the PAE unqualified to receive additional projects for restructuring under an existing PRA;

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

(4) Seek from a PAE or other restricted person HUD's actual, direct, and consequential damages resulting from the violation.

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

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

§ 401.314 Environmental review responsibilities.

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

Subpart C—Restructuring Plan

§ 401.400 Required elements of a Restructuring Plan.

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

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

§ 401.401 Consolidated Plans.

A PAE may request HUD to approve a Consolidated Restructuring Plan that presents an overall strategy for more than one project included in the PRA.

HUD will consider approval of a Consolidated Restructuring Plan for projects having common ownership, geographic proximity, common mortgagee or servicer, or other factors that contribute to more efficient use of the PAE's resources. Notwithstanding the more efficient use of a PAE's resources, HUD will not approve any Consolidated Restructuring Plans that have a detrimental effect on tenants or the community, or a higher cost to the Federal Government.

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

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

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

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

(b) *Grounds for rejection.*—(1) *Suspension or debarment.* Neither a PAE nor HUD will continue to develop or consider a Restructuring Plan if, at any time before a closing under § 401.407, the owner is debarred or suspended under part 24 of this title.

(2) *Other grounds.* HUD may elect not to permit continued consideration of the Restructuring Plan at any time before closing under § 401.407, if:

(i) An affiliate is debarred or suspended under part 24 of this title;

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

(iii) HUD or the PAE determines (under § 401.451(c) or otherwise) that the project does not meet the housing quality standards in § 401.558 and that the poor condition of the project is not likely to be remedied in a cost-effective manner through the Restructuring Plan.

(3) *Exception for sale.* This paragraph does not apply (except (2)(iii)) if a sale or transfer is proposed under § 401.480.

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

§ 401.404 Proposed Restructuring Commitment.

A PAE must submit a Restructuring Plan and a proposed Restructuring Commitment to HUD for approval, prior to submitting the Commitment to the owner for execution. The submission may not occur earlier than 10 days after the public meeting required by § 401.500(d). The proposed Restructuring Commitment must be in a form approved by HUD, incorporate the Restructuring Plan, and include the following:

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

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

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

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

(e) The uses for project accounts;

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

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

(h) All consideration, direct or indirect, received or to be received by the PAE or a related party, if known, in connection with any matter addressed in the Restructuring Commitment, except amounts paid or to be paid by HUD; and

(i) Other terms and conditions prescribed by HUD.

§ 401.405 Restructuring Commitment review and approval by HUD.

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

§ 401.406 Execution of Restructuring Commitment.

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

§ 401.407 Closing conducted by PAE.

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

§ 401.408 Affordability and use restrictions required.

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

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

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

(1) At least 20 percent of the units in the project must be leased to families whose adjusted income does not exceed 50 percent of the area median income as determined by HUD, with adjustments for household size, at rents no greater than 30 percent of 50 percent of the area median income; or

(2) At least 40 percent of the units in the project must be leased to families whose adjusted income does not exceed 60 percent of the area median income as determined by HUD, with adjustments

for household size, at rents no greater than 30 percent of 60 percent of the area median income.

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

(e) *Nondiscrimination against voucher holders.* An owner must comply with the nondiscrimination provisions of § 401.556.

(f) *Enforcement.* The Use Agreement must contain remedies for breach of the Use Agreement, including monetary damages for non-compliance with paragraphs (c) and (g) of this section.

(g) *Compliance with physical condition standards.* The Use Agreement must require that the property be maintained in compliance with the requirements of § 401.558.

(h) *Reporting.* The Use Agreement must contain appropriate financial and other reporting requirements for the owner. These reports must comply with the Real Estate Assessment Center protocol or subsequent standards required by HUD.

(i) *Enforcement and amendment.* The Use Agreement will be enforceable by interested parties to be specified in the Agreement, which will include HUD, the PAE, project tenants, organizations representing project tenants, and the unit of local government. The Use Agreement must require the party bringing enforcement action to give the owner notice and a reasonable opportunity to cure any violations.

(j) *Modifications.* HUD will retain the right to approve modifications of the Use Agreement agreed to by the owner without the consent of any other party, including those having the right of enforcement. The owner must post prominently on project property notice of any modifications approved by HUD.

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

§ 401.410 Standards for determining comparable market rents.

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

(b) *Comparable market rents defined.* Comparable market rents are the rents charged for properties that the PAE determines to be comparable properties (as defined in section 512(1) of MAHRA, but also excluding section 202 or section 811 projects assisted under part 891 of this title). For purposes of section 512(1), other relevant characteristics include any applicable rent control and other characteristics determined by the PAE. The PAE may make appropriate adjustments when needed to ensure comparability of properties.

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

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

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

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

§ 401.411 Guidelines for determining exception rents.

(a) *When do exception rents apply?* (1) The Restructuring Plan may provide for exception rents established under section 514(g)(2) of MAHRA for project-based assistance if the PAE determines that project income under the rent levels established under § 401.410 would be inadequate to meet the costs of operating the project as described in paragraph (b) of this section and that the housing needs of the tenants and the community could not be adequately addressed.

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

(b) *How are exception rents calculated?* (1) Exception rents must be set at a level sufficient to support the costs of operating the project. The PAE must take into account the following cost items:

(i) Debt service on the second mortgage under § 401.461(a) or a rehabilitation loan included in the Restructuring Plan;

(ii) The operating expenses of the project, as determined by the PAE, including:

(A) Contributions to adequate reserves for replacement;

(B) The costs of maintenance and necessary rehabilitation;

(C) Other eligible costs permitted under the section 8 program;

(iii) An adequate allowance for potential operating losses due to vacancies and failure to collect rents, as determined by the PAE;

(iv) A return to the owner to the extent permitted by § 401.461(b)(3)(ii)(A); and

(v) Other expenses determined by the PAE to be necessary for the operation of the project.

(2) The exception rent must not exceed 120 percent of the Fair Market Rent for the market area, except that HUD may approve an exception rent greater than 120 percent of Fair Market Rent, based on a narrative explanation of special need submitted by the PAE, subject to the 5 percent limitation in section 514(g)(2)(A) of MAHRA.

§ 401.412 Adjustment of rents based on operating cost adjustment factor (OCAF) or budget.

(a) *OCAF.* (1) The Restructuring Plan must provide for annual adjustment of the restructured rents for project-based assistance by an OCAF determined by HUD.

(2) *Application of OCAF.* HUD will apply the OCAF to the previous year's contract rent less the portion of that rent paid for debt service. This paragraph applies to renewals of contracts in subsequent years which receive restructured rents under either section 514(g)(1) or (2) of MAHRA.

(b) *Budget-based.* Rents will be adjusted on a budget basis instead of OCAF only upon owner request, subject to HUD approval.

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

The Restructuring Plan must provide for the section 8 contract to be renewed as project-based assistance, subject to the availability of funds for this purpose, if:

(a) The PAE determines there is a market-wide vacancy rate of 6 percent or less;

(b) At least 50 percent of the units in the project are occupied by elderly families, disabled families, or elderly and disabled families; or

(c) The project is held by a nonprofit cooperative ownership housing corporation or nonprofit cooperative housing trust.

§ 401.421 Rental Assistance Assessment Plan.

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

(b) *Matters to be assessed.* The PAE must include an assessment of the impact of converting to tenant-based assistance and the impact of extending project-based assistance on:

(1) The ability of the tenants to find adequate, available, decent, comparable, and affordable housing in the local market;

(2) The types of tenants residing in the project (such as elderly families, disabled families, large families, and cooperative homeowners);

(3) The local housing needs identified in the applicable Consolidated Plan developed under part 91 of this title;

(4) The cost of providing assistance, comparing the applicable payment standard to the rent levels permitted by §§ 401.410 and 401.411;

(5) The long-term financial stability of the project;

(6) The ability of residents to make reasonable choices about their individual living situations;

(7) The quality of the neighborhood in which the tenants would reside; and

(8) The project's ability to compete in the marketplace.

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

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

§ 401.450 Owner evaluation of physical condition.

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

(1) All work items required to bring the project to the standard in § 401.452, including any work items needed to ensure compliance with applicable requirements of part 8 of this title concerning accessibility to persons with disabilities;

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

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

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

(b) *Use of CA.* An owner may comply with paragraph (a) of this section by submitting a comprehensive needs assessment in accordance with Title IV of the Housing and Community Development Act of 1992 (12 U.S.C. 1715z–1a note) if the CA:

(1) Was completed or updated within 1 year; and

(2) Contains all of the matters required by paragraph (a) of this section.

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

§ 401.451 PAE Physical Condition Analysis (PCA).

(a) *Review and certification of owner evaluation.* (1) The PAE must independently evaluate the physical condition of the project by means of a PCA. If the PAE finds any immediate threats to health and safety, the owner must complete those work items immediately, or the PAE must evaluate the project's eligibility in accordance with § 401.403(b)(2)(iii).

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

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

(c) *Rejection due to poor condition of the project.* Based on the completed PCA, the PAE must determine whether proceeding with a Restructuring Plan with necessary rehabilitation is more cost-effective in terms of Federal resources than rejecting the Request for a Restructuring Plan under § 401.403(b)(2)(iii) and providing tenant-based assistance for displaced tenants under § 401.602. HUD will provide guidance to PAEs for making the determination. If the PAE concludes that a request for a Restructuring Plan should be rejected because of lack of cost-effectiveness due to poor condition of the project, it must also consider the effect on tenants and the community and advise HUD of the effect. HUD will make the final decision after considering the PAE's recommendation.

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

§ 401.452 Property standards for rehabilitation.

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

§ 401.453 Reserves.

The Restructuring Plan must provide for reserves for capital replacement sufficient to ensure the property's long-term structural integrity so that the property can be maintained as affordable housing in decent, safe, and sanitary condition meeting the standards of § 401.558.

§ 401.460 Modification or refinancing of first mortgage.

(a) *Principal amount.* As part of the Restructuring Plan, the PAE will

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

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

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

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

(e) *Refinancing.* (1) The owner must contact the mortgagee to determine the mortgagee's willingness to consider a modification and re-amortization of the existing first mortgage through a Restructuring Plan before considering any other source of first mortgage financing. If the mortgagee does not agree to modify and re-amortize in accordance with the Restructuring Plan, the loan must be refinanced.

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

(i) *FHA mortgage insurance.* If the Restructuring Plan provides for FHA mortgage insurance for the refinanced first mortgage, the insurance will be provided in accordance with all usually applicable FHA legal requirements except that insurance will be documented as provided in section 517(b)(2) of MAHRA. HUD will issue the commitment for mortgage insurance but may adapt its procedures as necessary to facilitate development and implementation of a Restructuring Plan.

(ii) *Other FHA credit enhancement.* If FHA credit enhancement, including risk-sharing, is provided under part 266 of this title, the credit enhancement will be provided in accordance with all usually-applicable FHA legal requirements under part 266 of this title, except that special approval from HUD will be required before the PAE engages in risk-sharing with FHA under part 266 of this title. HUD will approve risk-sharing financing that complies with part 266 whenever required by section 517(b)(3) of MAHRA.

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

§ 401.461 HUD-held second mortgage.

(a) *Amount.* (1) The Restructuring Plan must provide for a second mortgage to HUD whenever the Plan provides for either payment of a section 541(b) claim or the modification or refinancing of a HUD-held first mortgage that results in a first mortgage with a lower principal amount. The term ''second mortgage'' in this section also includes a new HUD-held first mortage (not a refinancing mortgage) if a full payment of claim is made under § 401.471, or if § 401.460(a) does not permit a restructured first mortgage in any amount.

(2) The second mortgage must be in a principal amount that does not exceed the lesser of:

(i) The amount the PAE reasonably expects to be repaid based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the property; and

(ii) The difference between the unpaid balance on the first mortgage immediately before and after the restructuring.

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

(2) The second mortgage must have a term concurrent with the modified or refinanced first mortgage, if any. HUD may provide that if there is no first mortgage, the second mortgage may continue for a term established by HUD.

(3)(i) Principal and interest on the second mortgage is payable only out of net cash flow during its term. ''Net cash flow'' means that portion of project income that remains after the payment of all required debt service payments on the modified or refinanced first mortgage, if any, including payment of any past due principal or interest, and payment of all reasonable and necessary operating expenses (including deposits to the reserve for replacement account) and any other expenditure approved by HUD.

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

(A) HUD or the PAE may approve the payment to the owner of up to 25 percent of net cash flow based on consideration of relevant conditions and circumstances including, but not limited to, compliance with the management standards prescribed in § 401.560 and the physical condition standards prescribed in § 401.558; and

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

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

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

(c) *Additional mortgage to HUD.* A Restructuring Plan may require the owner to give an additional mortgage on the project to HUD in an amount that does not exceed the difference between the amount of a section 541(b) claim paid under § 401.471 and the principal amount of the second mortgage. HUD will provide guidance to PAEs regarding the circumstances under which a Plan may be negotiated that provides for less than the full difference to be payable under the additional mortgage. This additional mortgage must be junior in priority to the second mortgage required by paragraph (a) of this section, bear interest at the same rate, which will accrue but not compound, and require no payment until the second mortgage is satisfied, when it will be payable

upon demand of the Secretary or as otherwise agreed by the Secretary.

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

HUD will pay a section 541(b) claim from the appropriate insurance fund to the insured mortgagee on behalf of the mortgagor. The mortgagee must use the claim payment to prepay the principal balance of the insured mortgage, in whole or in part, as provided in the Restructuring Plan. All section 541(b) claims will be paid in cash. Part 207 of this title and sections 207(g) and 541(a) of the NA do not apply to a section 541(b) claim.

§ 401.472 Rehabilitation funding.

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

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

(3) *Section 236(s) rehabilitation grant.* The Restructuring Plan may include a direct grant from HUD under section 236(s) of the NA made in accordance with § 401.473, to the extent that HUD has determined that funding is available for such a grant.

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

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

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

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

HUD will consider a direct grant for rehabilitation under section 236(s) of the NA only if the owner provides an acceptable work schedule and cost-analysis that is consistent with the owner's evaluation of physical condition under § 401.450, as certified by the PAE. The owner must execute a grant agreement with terms and conditions acceptable to HUD. If the PAE is a State or local government, or an agency or instrumentality of such a government, the PAE and HUD may agree that the PAE will be delegated the responsibility for the administration of any grant made under this section. HUD may make grant funding available for the cost of administration if HUD has determined that such funding is available.

§ 401.474 Project accounts.

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

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

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

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

§ 401.480 Sale or transfer of project.

(a) *May the owner request a Restructuring Plan that includes a sale or transfer of the property?* The owner may request a Restructuring Plan that includes a condition that the property be sold or transferred to a purchaser acceptable to HUD in a reasonable period needed to consummate the transaction. The failure to consummate a sale or transfer of the property requested under paragraph (a) of this section will neither adversely affect an owner's eligibility for a Restructuring Plan nor exempt the owner from the requirements of § 401.600. There are no priority purchaser requirements for a voluntary sale or transfer by an owner that is eligible for a Restructuring Plan.

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

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

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

(3) During a period to be determined by HUD that begins when the owner gives notice of intent to sell or transfer, an owner may accept an offer only from a priority purchaser.

(4) No sale or transfer to a non-priority purchaser will be approved without evidence of tenant support.

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

§ 401.481 Subsidy layering limitations on HUD funds.

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

(b) *Purpose of subsidy layering certification.* The purpose of the subsidy layering certification is to ensure that any HUD assistance provided to the owner of a project pursuant to a Restructuring Plan is no more than is necessary to permit the project to continue to house tenants with an income mix comparable to the income

mix of the project before the Restructuring Plan is implemented, after taking into account other Government assistance described in section 102(b)(1) of the Department of Housing and Urban Development Reform Act of 1989 (42 U.S.C. 3545(b)(1)). This section does not limit a PAE from presenting for approval a Restructuring Plan that includes project reconfiguration (*e.g.,* conversion of efficiency units to one-bedroom units) where necessary to meet the needs of the community, provided the conditions of § 401.452 are also met.

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

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

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

§ 401.500 Required notices to third parties and meeting with third parties.

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

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

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

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

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

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

(2) This notice must state how comments may be provided to the PAE regarding any of the following: the physical condition of the property, whether the rental assistance should be tenant-based or project-based, any proposed sale or transfer of the property, and other matters regarding the property and its management. The notice must establish the date, time, and place for a public meeting to be held no sooner than 20 days and no later than 40 days following the date of this notice. The public may provide written comments up to the date of the meeting.

(c) *Access to Restructuring Plan.* (1) The PAE must make the Restructuring Plan available to the parties identified in § 401.501 at least 20 days before the PAE submits the Restructuring Plan to HUD (subject to any Federal, State, or local laws restricting access to any information in the Plan or related documents).

(2) As soon as the PAE determines that the Restructuring Plan is substantively complete and ready for submission to HUD, notice of the following must be provided:

(i) The location of the Plan for inspection and copying; and

(ii) The date, time, and place of a public meeting to be held at least 10 days before the PAE submits the Plan to HUD.

(3) When the PAE gives notice under this section, it must make the Plan available during normal business hours at the management office of the project, or if there is no such office, at another location specified by the PAE that is convenient to the tenants.

(d) *Meeting to discuss the Restructuring Plan.* After the PAE has given notice under this section and at least 10 days before the PAE submits the Plan to HUD, the PAE must conduct a public meeting to obtain comments on the substantively completed Plan. The PAE must accept written comments through the date of the meeting.

(e) *Disposition of comments.* The PAE must document and provide to HUD with the Restructuring Plan a summary of the disposition of all public comments.

(f) *Notice of completion of Restructuring Plan.* (1) Within 10 days after the owner executes the Restructuring Commitment, notice must be provided that describes the completed Restructuring Plan and Restructuring Commitment. The PAE must make the completed Restructuring Plan and Restructuring Commitment available during normal business hours to the public at a place described in paragraph (c)(3) of this section, subject to Federal, State, or local laws restricting access to any information in any of these documents.

(2) Within 10 days after the PAE determines that the Restructuring Plan will not move forward for any reason, notice must be provided that describes the reasons for the failure to move forward and the availability of tenant-based assistance to tenants under § 401.602(c) if project-based assistance is not renewed.

§ 401.501 Delivery of notices and recipients of notices.

(a) *Whom must the owner or PAE notify?* The PAE must notify, or ensure that the owner notifies, each tenant and any tenant organization for the project, and post a notice in the project, for all notices required by §§ 401.500 and 401.502.

(b) *Whom must the PAE notify?* The PAE must notify:

(1) The Chief Executive Officer of the unit of local government and the Executive Director of the Public Housing Authority with jurisdiction over the project location;

(2) The recipient of any Outreach and Training Grant (OTAG); or Intermediary Technical Assistance Grant (ITAG) for the project location; and

(3) Other appropriate neighborhood representatives and other affected parties.

§ 401.502 Notice requirement when debt restructuring will not occur.

(a) *PAE responsibility.* If an owner of an eligible project requests a renewal of a section 8 contract without a Restructuring Plan under § 402.4, HUD or the PAE must notify, or ensure that the owner notifies, all parties identified in § 401.501 of the request and of:

(1) The availability (as provided in § 401.500(c)(3) of the following information:

(i) The owner evaluation of physical condition (OEPC) required by § 402.6(a)(3);

(ii) The comparable market rent analysis required by § 402.6(a)(2), but without addresses (or other specific information indicating location) for comparable properties; and

(iii) The items identified in § 400.500(b)(1)(i), (ii) and (iv); and

(2) A procedure for submitting public comments regarding this information.

(b) *Expense and profit/loss information.* The PAE should remove project expense, property valuation, and profit and loss information before disclosing any information obtained by the PAE directly from an owner or project manager, unless the owner has given written consent to disclosure with that information included.

(c) *Consideration of comments.* The PAE must consider written public comments on the information listed in paragraph (a) of this section, if the comments are submitted within 30 days after giving notice under paragraph (a), and document the consideration for HUD. No public meeting is required.

§ 401.503 Access to information.

(a) *PAE responsibilities.* The PAE must provide to parties entitled to notice under § 401.501 access to information obtained by the PAE about the project and its management if the PAE determines that such information is reasonably likely to contribute to effective participation by those parties in the restructuring process, or if HUD requires the PAE to provide access to the information. The PAE is not required to make public any information received from the owner or manager that the PAE reasonably characterizes as confidential or proprietary information that would not ordinarily be made public, except:

(1) Owner evaluation of physical condition (OEPC), or a comprehensive needs assessment (CA) if used instead of an OEPC, as required by § 401.450;

(2) Owner-prepared 1-year project rent analysis; and

(3) As directed by HUD.

(b) *Information on expenses and profit/loss.* Before disclosing any information, the PAE must remove any information obtained by the PAE directly from the owner or project manager that is related to project expenses, property valuation, or profit and loss, unless the owner gives written consent to disclosure with that information.

Subpart D—Implementation of the Restructuring Plan After Closing

§ 401.550 Monitoring and compliance agreements.

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

(b) *Periodic monitoring and inspection.* At least once a year, a PAE must review the status of each project for which it developed an approved Restructuring Plan. Monitoring must include on-site inspections. HUD will accept an inspection by a PAE that complies with subpart G of part 5 of this title in lieu of an inspection required by any other party under that subpart.

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

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

(2) The project is not currently subject to a PRA.

(d) *Regulatory agreement.* As long as the Secretary is the holder of a second mortgage or an additional mortgage under § 401.461, HUD will regulate the operations of the mortgagor through a regulatory agreement providing terms, conditions, and standards established by HUD, which may be in addition to any regulatory agreement otherwise required in connection with mortgage insurance programs. The regulatory agreement must contain remedies for breach, including monetary damages in the event of non-compliance.

§ 401.552 Servicing of second mortgage.

HUD or its designee will be responsible for servicing the second mortgage, including determining the amounts receivable by the owner under § 401.461(b)(3)(ii)(A). HUD may designate the PAE, with the PAE's consent, as servicer for the second mortgage.

§ 401.554 Contract renewal and administration.

HUD will offer to renew or extend section 8 contracts as provided in each Restructuring Plan, subject to the availability of appropriations and subject to the renewal authority available at the time of each contract expiration (§ 402.5 of this chapter or another appropriate renewal authority). The offer will be made by HUD directly or through a PAE that has contracted with HUD to be a contract administrator for such contracts. HUD will offer to any PAE that is qualified to be the section 8 contract administrator the opportunity to serve as the section 8 contract administrator for a project restructured under a Restructuring Plan developed by the PAE under the Mark-to-Market Program. Qualifications will be determined under both statutory requirements and requirements issued by the appropriate office within HUD, depending on the type of section 8 assistance that is provided.

§ 401.556 Leasing units to voucher holders.

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

§ 401.558 Physical condition standards.

The Restructuring Plan must require the owner to maintain the project, in a decent and safe condition that meets the applicable standards under this section. As long as project-based assistance is provided, the applicable standards are the physical conditions standards for HUD housing in § 5.703 of this title. At any other time, the applicable standards are the local housing codes or codes adopted by the public housing agency if such codes meet or exceed the standards in § 5.703 of this title and do not severely restrict housing choice or, if there are no such local housing codes or codes adopted by the public housing agency, the standards in § 5.703 of this title will apply. In addition, any unit in which the tenant receives tenant-based assistance must comply with the housing quality standards of the section 8 tenant-based programs.

§ 401.560 Property management standards.

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

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

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

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

(3) Maintain good relations with the tenants;

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

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

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

(c) *Conflicts of interest.* The PAE management standards must also conform to any guidelines established

by HUD, and industry standards, governing conflicts of interest between owners, managers, and contractors.

Subpart E—Section 8 Requirements for Restructured Projects

§ 401.595 Contract and regulatory provisions.

The provisions of chapter VIII of this title will apply to a renewal of section 8 project-based assistance contract under this part only to the extent, if any, provided in the contract. Part 983 of this title will not apply. The term of the initial and subsequent contract renewals under this part will be determined by the appropriate HUD official.

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

If a section 8 contract for an eligible project would expire before a Restructuring Plan is implemented, the contract may be extended at rents not exceeding current rents for up to the earlier of 1 year or closing on the Restructuring Plan under § 401.407. HUD may terminate the contract earlier if the PAE or HUD determines that an owner is not cooperative under § 401.402 or if an owner's request is rejected under § 401.403 or § 401.405. Any extension of the contract beyond 1 year for a pending Plan must be at comparable market rents or exception rents. An extension at comparable market rents or exception rents under this section will not affect a project's eligibility for the Mark-to-Market Program once it has been initially established under this part.

§ 401.601 [Reserved]

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

(a) *Required notices.* (1)(i) The owner of an eligible project who has requested a Restructuring Plan and contract renewal must provide a 12-month notice as provided in section 514(d) of MAHRA if the owner later decides not to extend or renew an expiring contract (except due to a rejection under §§ 401.101. 401.403, 401.405, or 401.451. If the owner gives such 12-month notice, the owner is not required to give a separate notice under section 8(c)(8) of the United States Housing Act of 1937.

(ii) An owner who gives the 12-month notice required by paragraph (a)(1)(i) of this section and who determines not to renew a contract must give additional notice not less than 120 days before the contract expiration.

(2) The owner of an eligible project who has not requested a Restructuring Plan, or an owner who requested a Restructuring Plan but who has been rejected under §§ 401.101, 401.403, 401.405, or 401.451, must provide 12 month's advance notice under section 8(c)(8)(A) of the United States Housing Act of 1937 (or notice as otherwise provided in section 8(c)(8)(C) of such Act), unless project-based assistance is renewed under § 402.4.

(3) Notices required by this paragraph must be provided to tenants and to HUD or the contract administrator. HUD will prescribe the form of notices under this paragraph, to the extent that the form is not prescribed by section 8(c)(8) of the United States Housing Act of 1937.

(b) *If owner does not give notice.* If an owner described in paragraph (a)(1) or (a)(2) of this section does not give timely notice of non-renewal or termination, the owner must permit the tenants in assisted units to remain in their units for the required notice period with no increase in the tenant portion of their rent, and with no eviction due to inability to collect an increased tenant portion of rent.

(c) *Availability of tenant-based assistance.* (1) Subject to the availability of amounts provided in advance in appropriations and the eligibility requirements of the tenant-based assistance program regulations, HUD will make tenant-based assistance available under the following circumstances:

(i) If the owner of an eligible project does not extend or renew the project-based assistance, any eligible tenant residing in a unit assisted under the expiring contract on the date of expiration will be eligible to receive assistance on the later of the date of expiration or the date the owner's obligations under paragraph (b) of this section expire; and

(ii) If a request for a Restructuring Plan is rejected under § 401.101, § 401.403, § 401.405, or 401.451, and project-based assistance is not otherwise renewed, any eligible tenant who is a low-income family or who resides in a project-based assisted unit on the date of Plan rejection will be eligible to receive assistance on the later of the date the Restructuring Plan is rejected, or the date the owner's obligations under paragraph (b) of this section expire.

(2) If the tenant was assisted under the expiring contract, assistance under this paragraph will be in the form of enhanced vouchers as provided in section 8(t) of the United States Housing Act of 1937.

§ 401.605 Project-based assistance provisions.

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

§ 401.606 Tenant-based assistance provisions.

If the Restructuring Plan provides for tenant-based assistance, each assisted family residing in a unit assisted under the expiring project-based assistance contract when the contract terminates will be offered tenant-based assistance if the family meets the eligibility requirements under part 982. Whenever permitted by section 515(c)(4) of MAHRA, the tenant-based assistance will be in the form of enhanced vouchers as provided in section 8(t) of the United States Housing Act of 1937.

Subpart F—Owner Dispute of Rejection and Administrative Appeal

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

(a) *Notice of rejection.* HUD will notify the owner of the reasons for a rejection under §§ 401.101, 401.402, 401.403, 401.405, 401.451, or § 402.7 of this chapter. An owner will have 30 days from receipt of this notice to provide written objections or to cure the underlying basis for the objections. If the owner does not submit written objections or cure the underlying basis for the objections during that period, the decision will become a final determination under section 516(c) of MAHRA and is not subject to judicial review.

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

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

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

(a) A final decision by HUD under § 401.645(b);

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

(c) A decision by HUD to accelerate the second mortgage under § 401.461(b)(4), to the extent provided that section.

§ 401.651 Appeal procedures.

(a) *How to appeal.* An owner may submit a written appeal to HUD, within 10 days of receipt of written notice of the decision described in § 401.650, contesting the decision and requesting a conference with HUD. At the conference, the owner may submit (in person, in writing, or through a representative) its reasons for appealing the decision. The HUD or PAE official who issued the decision under appeal may participate in the conference and submit (in person, in writing, or through a representative) the basis for the decision.

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

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

§ 401.652 No judicial review.

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

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

3. The authority citation for part 402 continues to read as follows:

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

4. Section 402.1 is revised to read as follows:

§ 402.1 What is the purpose of part 402?

This part sets out the terms and conditions under which HUD will renew project-based section 8 contracts under the authority provided in section 524(a)(1) or (2) of MAHRA. This part permits renewal notwithstanding part 24 of this title, but subject to section 516 of MAHRA (see § 402.7).

5. Section 402.4 is revised to read as follows:

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

(a) *Initial renewal.* (1) HUD may renew any expiring section 8 project-based assistance contract at initial rents that do not exceed comparable market rents.

(2)(i) If HUD or a Participating Administrative Entity (PAE) determines that renewal of an expiring contract under this section for an eligible project would be sufficient to maintain both adequate debt service coverage on the HUD-insured or HUD-held mortgage and necessary replacement reserves to ensure the long-term physical integrity of the project, taking into account any comments received under § 401.502(c) of this chapter, HUD will renew the contract under this section without developing a Restructuring Plan, subject to § 402.7.

(ii) If HUD or the PAE determines that paragraph (a)(2)(i) of this section does not apply for an eligible project, HUD or the PAE may require a Restructuring Plan before the owner's request for renewal of an expiring section 8 contract will be given further consideration. If HUD or the PAE determines that the project's continued operation without a Restructuring Plan is not feasible and the owner does not cooperate in the development of an acceptable Restructuring Plan, HUD will pursue whatever administrative actions it considers necessary.

(b) [Reserved].

6. Section 402.6 is amended by revising paragraph (a)(3) to read as follows:

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

(a) * * *

(3) If an owner of a project eligible for restructuring under part 401 is seeking contract renewal under § 402.4, the most recent required fiscal year audited financial statement for the project and an owner's evaluation of physical condition as provided in § 401.450 of this chapter, and such other documents as HUD or the PAE may require.

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Dated: March 13, 2000.

Ira Peppercorn,

Director, Office of Multifamily Housing Assistance Restructuring.

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