

Memo on Administrative Review of Rent Increases for HUD-Subsidized Properties

[as of Feb. 14, 2012, this is the guts of the prior Green Book on administrative review of HUD-subsidized rent increases, to be reviewed for determination of best approach for CW – (1) revised and updated memo, or (2) as is (with note that not revised or updated since 2004).

NOTE: the draft of the remaining Project-Wide Rents section still includes reduced text of the sections (“Part A”) included here up to, but not including, section 4.3.2.1. so, if the reduced text is retained in the main draft, then Part A can be deleted from any CW memo]

[part A]

As tenants can expect very little in the way of judicial review in this area, emphasis must be placed on the administrative process by which HUD decides whether to approve a rent increase and a thorough financial analysis of the owner’s application to HUD. For a long time, HUD has simply rubber-stamped these applications. By careful review of their contents, however, tenants can sometimes successfully force HUD to disallow or at least reduce the owner’s requested rent increase. Moreover, rent increase issues provide an ideal opportunity for tenants to begin the formation of a tenant organizations that can more effectively negotiate with owners on other issues of concern.

Many tenants in HUD-subsidized developments are directly affected by development-wide rent increases. Nevertheless, a few tenants -- those with additional rental subsidies and those higher-income tenants paying more than the HUD-subsidized flat rents, may not experience financial impact when unit rents increase. For example, Section 8 tenants’ rent contributions will not rise as a result of a development-wide rent increase, but the contract rent for the unit will increase. Most Rent Supplement tenants will not be directly affected by a development-wide rent increase, except those Rent Supplement tenants who pay the minimum rent of 30 percent of the basic or economic rent.¹ Nevertheless, all tenants in these developments should be concerned that the proposed rent increase adequately covers needed maintenance and operating costs, and that rental income is actually used for those purposes.

Numerous HUD-subsidized developments contain a mix of units with some having additional Section 8 subsidies and others with rents set at the basic or contract rent level. In these mixed developments, it is often difficult for owners to implement needed rent increases because of the severe impact that may be felt by the non-Section 8 households, many of whom may in fact be Section-8 eligible. In an effort to mitigate this problem, and lacking the ability to provide additional Section 8 to assist unsubsidized residents, a number of HUD offices have implemented “two-tier” rent structures, whereby the rents for the Section 8 units are set at different and higher levels than those of the unsubsidized units. Thus, the burden of supporting the rent increase is placed disproportionately onto the federal government. This strategy has been particularly effective and helpful in Sections 202 and 236 housing for seniors, where the unsubsidized units are frequently occupied by Section 8-eligible households, who often pay more than 50 percent of their incomes for rent, while awaiting the opportunity to obtain an available Section 8 subsidy.

One other general fact to remember when evaluating a proposed HUD-subsidized rent increase is the difference between tenant rent and the total rent for the unit. In determining whether or not tenants are receiving adequate or comparable services to unsubsidized units for the rent paid, the key figure is the overall rent, including the full subsidy for the unit, not just the tenant’s rent contribution. The key figure for all Section 236 tenants, including those who receive Section 8, Rent Supplement or Rental Assistance Payments (RAP) benefits, is the “Section 236 market rent.” The Section 236 market rent is the rent that would have to be paid for the unit if the owner did not receive the benefit of an interest reduction subsidy payment, and it covers operating costs, principal and the full mortgage interest.² For all Section 221(d)(3) BMIR tenants, the relevant rent for comparison to unassisted levels is the HUD-approved contract rent.

¹ See former 24 C.F.R. § 215.45(b)(2) (1995).

² 12 U.S.C.A. § 1715z-1(f)(1) (West 2001). See also □ 3.2.4 for a discussion of these rents.

4.3.1 Procedural Requirements

The development-wide rent increase process begins when the owner, deciding that an increase is necessary, formulates a proposal. Before HUD approval of the proposal can be granted, the owner or the owner's agent must comply with the published procedural regulations.³ HUD adopted these informal review procedures only after subsidized housing tenants filed numerous lawsuits asserting that HUD's approval of rent increase applications, without affording them notice and a prior opportunity to be heard, violated due process and implied statutory rights. While all federal circuit courts seem to agree that HUD-subsidized tenants do not have a right to a full adjudicatory hearing,⁴ more than a half dozen courts have held that tenants are entitled to limited procedural protections, including notice of the proposed rent schedule with supporting information and an opportunity to present written objections to the owner's proposal.⁵

4.3.1.1 Federal Regulations

The regulations⁶ require that the owner notify the tenants, by delivery or posting, of the rent increase proposal at least 30 days before filing the application with HUD. If during the 30-day comment period a material change is made in the available materials, the tenants have a period of 15 days from the date of

³ 24 C.F.R. §§ 245.305-245.330 (2003). *See also* 12 U.S.C.A. § 1715z-1b (West 2001) (tenant participation in multifamily housing developments); *Roxse Homes, Inc. v. Sec'y of HUD*, No. 87-1031 (Mass. Bankr. filed Mar. 10, 1987), 21 CLEARINGHOUSE REV. 177 (No. 42,322, June 1987) (denying owner's request for preliminary injunction to impose 28-percent rent increase without HUD approval and notice to tenants); *In re Application for a Rental Increase at Zion Towers Apts. (HMFA #2)*, 782 A.2d 956 (N.J. Super. Ct. App. Div. 2001) (recommendation by state agency for rent increase in state-financed Section 236 property not final decision for purposes of appeal).

⁴ The following courts have ruled tenants have no right to a full evidentiary hearing because they have no legitimate claim of entitlement to reside in subsidized housing at a fixed rent: *Grace Towers Tenants Ass'n v. Grace Hous. Dev. Fund, Inc.*, 538 F.2d 491 (2d Cir. 1976); *Harlib v. Lynn*, 511 F.2d 51 (7th Cir. 1975); *People's Rights Org. v. Bethlehem Assocs.*, 356 F. Supp. 407 (E.D. Pa. 1973), *aff'd mem.*, 487 F.2d 1395 (3d Cir. 1973); *Langevin v. Chenango Court, Inc.*, 447 F.2d 296 (2d Cir. 1971); *Hahn v. Gottlieb*, 430 F.2d 1243 (1st Cir. 1970); *Fenner v. Bruce Manor*, 409 F. Supp. 1332 (D. Md. 1976); *Medlin v. Fickling and Walker Dev. Co., Inc.*, 420 F. Supp. 811 (N.D. Ga. 1976). *See also Reiner v. West Village Assocs.*, 768 F.2d 31 (2d Cir. 1985) (tenants challenging rent increase in developments with Section 223(b) HUD-insured loan have no property interest to trigger due process and are not third-party beneficiaries of Regulatory Agreement); *Tenants' Council of Tiber Island-Carrollsberg Square v. Lynn*, 497 F.2d 648 (D.C. Cir. 1973), *cert. denied*, 419 U.S. 970 (1974) (tenants of Section 220 insured development are not entitled to participate in rent increase process); *Beechwood Gardens Tenants' Ass'n v. Department of Hous.*, 572 A.2d 989, 214 Conn. 505 (1990) (development-wide rent increase for state-subsidized, moderate-income complex not subject to due process challenge because approval had been obtained during development phase).

⁵ *Marshall v. Lynn*, 497 F.2d 643 (D.C. Cir. 1973), *cert. denied*, 419 U.S. 970 (1973); *Geneva Towers Tenants Org. v. Federated Mortgage Investors*, 504 F.2d 483 (9th Cir. 1974); *Keller v. Kate Maremount Found.*, 365 F. Supp. 798 (N.D. Cal. 1972); *Dew v. McLendon Gardens Assocs.*, 394 F. Supp. 1223 (N.D. Ga. 1975); *Bloodworth v. Oxford Village Townhouses*, 377 F. Supp. 709 (N.D. Ga. 1974); *Paulsen v. Coachlight Apts. Co.*, 507 F.2d 401 (6th Cir. 1974); *Burr v. New Rochelle Mun. Hous. Auth.*, *supra* note **Error! Bookmark not defined.**.. *But see Thompson v. Washington*, *supra* note **Error! Bookmark not defined.**

⁶ 24 C.F.R. §§ 245.305-330 (2003).

service of the additional materials to review the new items.⁷ The notice must contain the amounts of proposed increases and the supporting “reasons,” as well as the location where supporting documentation will be available for examination by the tenants and a brief description of the tenants’ right to comment.⁸ When this notice is given to the tenants, the owner sends a copy to the local HUD office, along with the required documents supporting the rent increase, including the Budget worksheet⁹ and a narrative statement of the supporting reasons.¹⁰ After expiration of the 30-day tenant comment period, the owner files the formal application with HUD, containing copies of the tenants’ written comments, the owner’s evaluation of those comments and various certifications. HUD considers the application and determines to what extent a rent increase will be permitted. HUD field offices are instructed to make an initial assessment of the rent increase request during the tenant comment period and are required to rule upon a rent increase request within 30 days after receipt of the entire package with tenant comments.¹¹ Upon receipt of HUD’s decision, before the increase can take effect, the owner must provide a 30-day notice to the tenants, by posting or delivery, of the result and the reasons for the approval.¹²

4.3.1.2 Applicability of Federal Regulations

The procedural rent increase regulations are applicable to Section 236, Section 221(d)(3) BMIR, Rent Supplement or any development formerly insured or assisted under these provisions before acquisition by HUD and sold subject to a mortgage insured or held by HUD and an agreement to maintain its low- and moderate-income character. In addition, Section 202 and 811 projects for the elderly or people with disabilities are covered, as are certain project-based Section 8 developments which were converted from Rent Supplement.¹³

Unfortunately, cooperatives have been expressly exempted from the coverage of these regulations.¹⁴ HUD presumably did this because it believes that cooperatives will obtain resident input from within the organization. (Carrying charges for cooperatives are formally adopted by the Board of Directors who are elected by the cooperative members.)¹⁵ Despite HUD assumptions, some cooperative boards have not

⁷ *Id.* § 245.310.

⁸ *Id.*

⁹ In 1998, HUD implemented its Rule on Uniform Financial Reporting Standards, which requires that the submissions discussed in this chapter must all be transmitted to HUD electronically. 24 C.F.R. § 5.801(b)(2) (2003).

¹⁰ HUD, MULTIFAMILY ASSET MGMT. AND PROJECT SERVICING 4350.1 REV-1, through CHG-9 (Sept. 1992 - Jan. 1996), ¶ 7-22 (Sept. 1992), and 24 C.F.R. § 245.315 (2003) (listing additional materials that must be sent to HUD in support of rent increases). *See also* § 4.3.2, *infra*, which lists additional materials that must be submitted.

¹¹ *Reynolds Assocs. v. United States*, 31 Fed. Cl. 335 (1994) (HUD's failure to meet handbook deadline for approving rent increases did not constitute breach of its regulatory agreement with Section 236 owner). *See HUD Tenants Coalition v. HUD*, 274 Fed. Appx. 124 (3d Cir. 2008) (finding that Section 236 residents were provided adequate information to review and comment on owner’s rent increase request).

¹² 24 C.F.R. §§ 245.15 and 245.310 (2003).

¹³ *Id.* § 245.10.

¹⁴ *Id.* § 245.10(b).

¹⁵ FHA Form 3245, Model Form of By-Laws (for use by Cooperatives in Sections 213, 221 and 236 cases) (June 1970), Art. V, § 2, reprinted in HUD, BASIC COOPERATIVE HOUSING INSURED HANDBOOK, 4550.1 through CHG-3 (May 1973-June 1977), App. 1-11 (May 1973). *See also* HUD HANDBOOK, 4350.1, *supra* note 10, ¶ 7-5.

established a good rapport with their members and thus the input of other residents is neither sought nor considered. For cooperators who are faced with this situation, the options include electing new members to the board of the cooperative, working with the existing board to make it more responsive and/or seeking HUD intervention.

The cooperative board should make available to other members the budget information which supports the proposed carrying charges. If the information is difficult to obtain locally, the cooperators should consider seeking the information from HUD under a Freedom of Information (FOIA) request (*see infra* re FOIA). If a member or a group of members are dissatisfied with the rent increase request and the Board is unresponsive, comments should be submitted directly to HUD. It is likely but not required that these comments will be considered by HUD. Whether the members of the cooperative could successfully sue to set aside an increase in the carrying charges should depend upon the condition of the building, the extent and justification for the increase and the degree to which the other cooperators have been excluded from the process.

Non-insured Section 236 developments are covered by the HUD-subsidized rent increase regulations. However, the state or local agency that has insured the development assumes some of the functions typically performed by HUD. Nevertheless, HUD makes the final decision on whether or not the rent increase request is granted.¹⁶

4.3.1.3 Regulatory Violations

Should the owner or the owner's agent violate the procedural regulations, tenants should immediately demand that HUD require full compliance by the owner. Tenants have been successful in getting HUD to require strict compliance with the regulations. For example, tenants in a Michigan development successfully argued to HUD that the notice of the proposed rent increase was inadequate because the materials supporting the rent increase were not available at the project site.¹⁷

The judicial response to violations of the procedural requirements may be less sympathetic than HUD's, especially for more minor violations. Courts have typically acted on a procedural violation only if the facts show that the violation is substantial or prejudicial to the tenants' interest.

In dealing with the question of procedural violations, one federal judge has defined a substantial violation as one that affects the decision-making process by impeding either the tenants' overall opportunity to review the rent increase application and express themselves or HUD's opportunity to receive and review materials.¹⁸

Within this context, a challenge alleging that the materials supporting the rent increase request were not "available" because the location was 45 minutes distant by public transportation from the development failed,¹⁹ as has a challenge that the approval did not reflect that HUD had adequately

¹⁶ 24 C.F.R. § 245.330 (2003).

¹⁷ See Letter from Robert E. Koenig, Chief of Loan Mgmt., HUD Detroit Area Office, to Hollis Turnham, Staff Attorney, Legal Servs. of S.E. Mich. (Feb. 27, 1979), as reported in 9 HOUS. L. BULL. 19 (July/Aug. 1979) (copy on enclosed CD). See also Letter from Leonard J. Ferrantino, HUD, to Alfred Shaw, MassHousing (Jan. 14, 2005) (copy on 2010 Supplement Companion Website) (HUD approval of rent increase was rescinded where mortgagor failed to comply with 24 C.F.R. pt. 245 resident participation requirements and HUD and DOJ Limited English Proficiency guidance).

¹⁸ *Tatro v. Harris*, No. H-77-69 (D. Conn., July 7, 1978) (Clearinghouse No. 48,324)). See also Note, *Violations by Agencies of Their Own Regulations*, 87 HARV. L. REV. 629 (1974).

¹⁹ See *Dew*, *supra* note 5 at 1236 (N.D. Ga. 1975). See also *Taylor v. Harris*, 452 F. Supp. 88 (D. Conn. 1978) (injunction denied because procedural violations were minor); *Moorehead v. Harris*, 448 F. Supp. 1214 (N.D.N.Y. 1978) (same).

considered tenant comments or that HUD did not state its reasons for approving the rent increase with sufficient particularity.²⁰

Should a “substantial” violation affecting the decision-making process be found, the tenants may obtain an injunction against the rent increase, or rescission of the increase and restitution of any rent increase amount already paid. In a Rhode Island case,²¹ where HUD approved the rent increase before receiving the tenant comments, the court enjoined the rent increase. Tenants in another case, in addition to obtaining injunctive and declaratory relief, forced the owner to refund the amount of the rent increases already paid by showing that: (1) the materials submitted by the owner in support of the rent increase were not available for inspection and comment by the tenants; (2) the rent increase was implemented on less than 30-days notice; and (3) tenants were not properly notified when the supporting materials submitted to HUD would be available for inspection and comment.²²

4.3.2 Introduction: Seeking an Administrative Review

Challenges to the merits of development-wide rent increases in subsidized housing are most successfully waged in the administrative forum.²³ Tenants should take full advantage of the procedural requirements set forth in the published regulations to review the rent increase proposal to determine if the proposed rent increase is warranted. If problems are identified, submitting a detailed analysis of the owner’s proposal may convince HUD to reduce the proposed rent increase. Alternatively, HUD may grant the rent increase contingent upon the owner making certain repairs or other improvements to the development. In any case, because understanding HUD’s own internal review process is useful, you should read the budget-based rent increase chapter of HUD’s Handbook.²⁴

The foundation for a successful challenge is adequate time and information. Often the 30-day comment period is insufficient to evaluate all the information. If possible, therefore, advocates should periodically examine HUD files for the pertinent project. Alternatively, advocates might request that HUD

²⁰ *Tatro*, *supra* note 18; *Dew*, *supra* note 5. *But see Turek v. Lynn*, No. 74-3120 (C.D. Cal. Oct. 31, 1974) (Clearinghouse No. 48,326) (ordering HUD to address tenant concerns, but not enjoining rent increase); *Ballou v. HUD*, No. –90-659 (TFGD) (D. Conn. filed Apr. 15, 1991), 25 CLEARINGHOUSE REV. 277 (No. 46,618, July 1991) (plaintiffs alleged, *inter alia*, that HUD failed to explain reasons for approving rent increase).

²¹ No. 76-0286 (D.R.I. Nov. 19, 1976) (Clearinghouse No. 48,322). *See also Ballou v. HUD*, *supra* note 20 (TRO issued to block 35 percent rent increase; plaintiffs alleged, *inter alia*, that there was no explanation for increase in operating expenses above inflation level and HUD failed to explain reasons for approval); *Walker v. Kemp*, No. CV-84-4370 (C.D. Cal. July 10, 1989) (Clearinghouse No. 45,132) (denying HUD summary judgment because disputed factual issue regarding tenant access to information HUD relied upon).

²² *Shivers v. Harris*, No. C78-317A (N.D. Ga., judgment entered, Apr. 25, 1978), 4 CLEARINGHOUSE REV. SUPP. 139 (No. 24,259, Sept. 1978), CCH POV. L. REP. ¶ 26,267 (Sept. 1978). *See also Miller v. Bergland*, No. 77-1075 (D. Idaho stipulated judgment and order June 6, 1977), 11 CLEARINGHOUSE REV. 257 (No. 21,164, July 1977) (FmHA Section 515 housing); *Rodriguez v. Bergland*, No. 78-1233 (D. Idaho, order Feb. 25, 1980) (Clearinghouse No. 48,323) (court declared trust over rents collected in violation of procedural regulations and ordered that funds be used for benefit of future tenants in FmHA (now RHS) Section 515 project).

²³ *But see Frakes v. Harris*, No. S-79-72 PCW (E.D. Cal. order Aug. 31, 1979) 13 CLEARINGHOUSE REV. 989 (No. 28,443, Apr. 1980), *aff’d sub nom. Frakes v. Pierce*, 700 F.2d 501 (9th Cir. 1983) (HUD responded minimally to administrative appeal by tenants and did not react significantly until court granted preliminary injunction; when tenants sought greater relief, HUD appealed and court denied tenants’ claim, citing lack of judicial review).

²⁴ HUD Handbook 4350.1, *supra* note 10, Ch.7 and ¶ 7-22 (Sept. 1992).

extend the review and comment period in particularly complicated cases. However, HUD staff may be reluctant to extend the comment period because of the administrative framework that urges prompt response to an owner's request for a rent increase.²⁵

The procedural regulations require the owner to make available during the comment period specific materials justifying the rent increase application.²⁶ If the owner is using the "forward-budget" method (as do most), these materials include: a cover letter summarizing the need for the request, a copy of the notice to the tenants of the proposed rent increase, a Budget Worksheet (Income and Expense Projections),²⁷ a statement explaining the expense lines on the worksheet, a partially completed Rent Schedule, a status report on the implementation of the current Energy Conservation Plan, the utility allowance for each unit, if applicable; the owner's certification regarding purchasing practices and reasonableness of expenses, and a request for increase in the reserve fund, if applicable.²⁸

Additional forms and information that may be quite useful in evaluating rent increase proposals are:

- (1) copies of the audited financial statements for prior years;
- (2) monthly receipts and disbursement statements;
- (3) analysis of the development's reserve account;
- (4) the HUD Real Estate Assessment Center (REAC) Physical Inspection Report and any mortgagee on-site inspection reports;²⁹
- (5) any HUD management review;³⁰
- (6) the management agreement;³¹
- (7) a copy of the Regulatory Agreement;³²

²⁵ See § 4.3.1.1, *supra*, discussing the HUD time frame for responding to a rent increase request.

²⁶ 24 C.F.R. §§ 245.310 and 245.315 (2003); HUD Handbook 4350.1, *supra* note 10, ¶¶ 7-8 and 7-22 (Sept. 1992).

²⁷ See HUD Form 92547-A (8/2000), Budget Worksheet, Income and Expense Projections, available from www.hudclips.org.

²⁸ 24 C.F.R. § 245.315(b) (2003). The last two items are not specified in the regulations, but in HUD Handbook 4350.1, *supra* note 10, ¶ 7-22 (Sept. 1992).

²⁹ See § 8.3.5.1, *infra*, for discussion of the Physical Inspection Summary Report and REAC. See also HUD form 9822, Physical Inspection Report (1/90), available from www.hudclips.org.

³⁰ HUD Form 9834, Management Review Summary Sheet and Questionnaire (9/91), available from www.hudclips.org. See also § 11.2.1, *infra*, for discussion of the HUD management review.

³¹ HUD requires a form that provides information about the management company and another regarding previous participation. See HUD form 9832, Management Entity Profile (8/91) and HUD form 2530 Previous Participation Certification (5/2001). Formerly, HUD also required a management agreement for each development and provided a sample agreement.

³² FHA Form 1730, Regulatory Agreement for Ltd. Distribution Mortgagor Projects Under Section 221(d)(3) of the National Housing Act (copy on enclosed CD); Form 1733, Regulatory Agreement for Non-Profit and Public Mortgagors Under Section 221(d)(3) of the National Housing Act (copy on enclosed CD); FHA Form 3134, Regulatory Agreement for Builder-Seller Mortgagors Under Section 236 of the National Housing Act (copy on enclosed CD); FHA Form 3135, Regulatory Agreement for Non-Profit Mortgagors Under Section 236 of the National Housing Act (copy on enclosed CD); FHA Form 3136, Regulatory Agreement for Limited Distribution Mortgagors Under Section 236 of the National Housing Act (copy on enclosed CD); HUD form 92465, Regulatory Agreement for

(8) any repair schedule required by a transfer of physical assets,³³ Flexible Subsidy or workout agreements,³⁴ and

(9) previous rent increase packages.

The Budget Worksheet sets forth the projected expenses for the coming year. The annual financial reports provide information regarding the financial condition of the development, including the statement of assets and liabilities for the year audited. These reports should be reviewed to determine the financial condition of the development, the cash available, accounts payable, reserve fund balances and cash flow, if any, to the owner.

HUD generally discourages any attempt to solicit from an owner information beyond what is required to support a rent increase. However, monthly receipts and statements of disbursements, usually required only during rent-up or financial trouble, may also be required by HUD to justify a rent increase. This may happen in cases where actual or projected expenses are excessive and the estimates will have a significant impact on rents.³⁵

The Real Estate Assessment Center (REAC) Physical Inspection Summary Report may provide valuable information about the condition of the development. Although the Management Review Summary and Questionnaire will not be available for most developments, the Questionnaire is particularly helpful, if available. It requests HUD reviewers to answer more than 40 multi-part questions pertaining to project management. The questions cover areas such as: maintenance and security, financial management, leasing and occupancy, tenant-management relations, drug-free housing policy, and general management practices. The Summary Sheet of the Management Review summarizes the answers to the Questionnaire.

All of these additional documents and information should be available at the local HUD office. In addition, HUD probably has other pertinent information in its files. Some local HUD offices may make development files available upon informal request. Other HUD area offices require the filing of a formal Freedom of Information Act (FOIA) request, and HUD may assert privileges against disclosure.³⁶ Appendix 4 to this Chapter provides a sample FOIA request for a rent increase situation. Note that ordinary FOIA response deadlines (20 working days) will not provide information in sufficient time for commenting on a rent increase request (30 days' notice prior to HUD submission, which is effectively 20 working days), so either you must seek this information earlier, or get expedited processing of the FOIA request.³⁷

Due to the time constraints operating when reviewing a rent increase request, advocates should bear in mind that the Budget Worksheet³⁸ will provide a statement of the development's expenses and revenues

Insured Multifamily Housing Projects (with Section 8 Housing Assistance Payments Contracts) (June 1977), available from www.hudclips.org.

³³ See HUD Handbook 4350.1, *supra* note 10, Ch. 13 (Sept. 1992), concerning change in ownership – transfer of physical assets.

³⁴ See HUD Handbook 4350.1, *supra* note 10, Ch. 11 (Sept. 1992), concerning workouts for HUD-held developments.

³⁵ HUD Handbook 4350.1, *supra* note 10, ¶ 7-25.D (Sept. 1992).

³⁶ 5 U.S.C.A. § 552 (West, WESTLAW through Pub. L. No. 108-120, 2003) and 24 C.F.R. § 15.101, *et seq.* (2003). See § 12.9, *infra*, for general discussion of FOIA and FOIA requests.

³⁷ 24 C.F.R. §§ 15.103(d)(7), 15.104(d), and 15.105(b) (2003) (providing for 10-day response if HUD finds compelling need).

³⁸ HUD Form 92547-A, *supra* note 27.

for the last year and the projected expenses for the coming year. These forms will not, however, provide information regarding the project's assets or liabilities. If there is time, an advocate might want to review, for example, this year's Budget Worksheet and compare it with last year's to see if the owner was able to project accurately expenses and income and to see which expenses increased or decreased.

HUD may also have information on comparable rents and expenses for subsidized properties. This information may be compiled by HUD staff who are responsible for reviewing rent increase requests. Over the years, HUD has had numerous electronic systems that contain information regarding comparable rents or expenses which advocates could request to review.

Finally, the area of subsidized housing development-wide rent increases is a tangled web of complex financial data, HUD forms, handbooks, inconsistent accounting practices, and negligent or cursory review procedures.³⁹ Confusion is inevitable, but it can be minimized. An awareness of certain features of the entire process should help. Also, outside expertise can be invaluable. In many communities, *pro bono* Certified Public Accountants may be available to assist. Other sources of expertise could be a local business school or possibly other multifamily housing managers, especially those associated with nonprofits and cooperatives.

[END of Part A]

4.3.2.1 Regulatory Framework and Standards

The Sections 236 and 221(d)(3) statutes, applicable HUD regulations,⁴⁰ handbooks and the regulatory

³⁹ A 1984 GAO report found that HUD and project owners were making mistakes that could be corrected and which, if not corrected, result in higher rents for tenants. In particular, the GAO report found that projects owners were not submitting the required information to HUD when applying for rent increases and failed to adequately document rent increase requests. The GAO report also concluded that HUD has approved excessive rent increases because of incorrect treatment of owner expenses and calculation errors. Additionally, the GAO report found that the fees paid to management during the operating year often exceeded the amount originally approved. *Improving Controls Over Rent and Management Fees at Multifamily Housing Projects*, GAO/RCED-84-118 (Government Accounting Office, Apr. 11, 1984).

⁴⁰ Prior to 1996, there were extensive regulations regarding HUD-insured and HUD-subsidized properties. Allegedly to "streamline" the regulatory system, HUD removed many of the regulations, including those regarding rent calculation and increases, in a final rule at 61 Fed. Reg. 14,396 (Apr. 1, 1996). The Section 236 regulations were specifically saved by 24 C.F.R. § 236.1(c) (2003). However, many of the regulations pertinent to rent calculations in these properties simply disappeared without a notice and comment period, allegedly because they were no longer necessary or duplicative of the statutes they supported, 12 U.S.C.A. § 1715l(d)(3) (West 2001) (for Section 221(d)(3) properties); 12 U.S.C.A. § 1715z-1(f) (West 2001) (for Section 236 properties). For example, Section 221(d)(3) properties were governed by 24 C.F.R. § 221.530 (1995), which referred to 24 C.F.R. § 207.19 (1995) for the detailed regulations on rent calculation. Both of these regulations were removed in 1996, with no savings provision and no specific reference to their prior purpose of regulating rent calculations. Thus the regulatory picture for some properties remains confused. 24 C.F.R. § 207.499 (2003) states that the Subpart may be amended, so long as the amendments do not adversely affect the interests of the mortgagee or lender. The amendment that eliminated the regulations is not likely to adversely affect either of those parties, but may well adversely affect tenants, a group unmentioned in the amendment clause. The HUD Handbook on rents in HUD-insured and HUD-subsidized properties, HUD, MULTIFAMILY ASSET MANAGEMENT AND PROJECT SERVICING 4350.1 REV-1, through CHG-9 (Sept. 1992 - Jan. 1996), has not been updated since before the removal of the regulations and HUD has published no notices specifically addressing the issue. Thus, where necessary, advocates

agreements set out standards to be applied by HUD in establishing rent levels, approving project expenses and controlling items such as return on investment, capital improvements, and the development's physical condition. There is no doubt that HUD has the authority to regulate rents.⁴¹

For Section 236 developments, rent levels are based upon operating expenses and debt service for an amortized mortgage at a hypothetical one percent.⁴² Section 221(d)(3) rents may be based upon a market interest rate or a below market interest rate, depending on the original financing chosen.⁴³ For Section 221(d)(3) developments, the Regulatory Agreement permits rent increases to cover expenses over which the owner has "ineffective control."⁴⁴ All expenses should be comparable to other similar developments.⁴⁵ HUD instructs that expenses must be reviewed to avoid either underestimating or overestimating expenses.⁴⁶ In addition, the owner must certify the reasonableness of development expenses.⁴⁷

For Sections 236 and 221(d)(3) BMIR developments or developments with Rent Supplement contracts, HUD authorizes rents to be based upon forward budgeting rather than historic costs.⁴⁸ Nevertheless, historic costs should be reviewed in evaluating the reasonableness of the projected expenses. Subsidized owners, unlike unsubsidized owners, cannot increase rents increased because comparable developments have higher rents or because of increased equity in the building, at least until they prepay the loan or are offered additional preservation incentives to remain in the program when their use restriction or contract term has expired. Advocates will need to review proposed budgets carefully to determine if the projected costs are realistic.

One court has confirmed that HUD's authority to regulate rents is not limited to approving or disapproving an owner's proposed rent adjustment. HUD has the right to initiate a rent adjustment, including a reduction.⁴⁹ In *Beck Park*, the court upheld HUD's right to order the owner to reduce the rents

should argue that the old regulatory scheme, though not technically still in the C.F.R., still applies. Throughout this Chapter, we refer to the former regulations where relevant, assuming that their contents would still apply.

⁴¹ For Section 236, see 12 U.S.C.A. § 1715z-1(f) (West 2001) and 24 C.F.R. § 236.55(a) (1995), saved by 24 C.F.R. § 236.1(c) (2003); for Section 221(d)(3), see 12 U.S.C.A. 1715(d)(3) (West 2001) and former 24 C.F.R. § 221.530 (1995). See also *Kargman v. Sullivan*, 552 F.2d 2, 5 (1st Cir. 1977), *reh'g denied*, 558 F.2d 612, *appeal after remand*, 582 F.2d 131 (1st Cir. 1978).

⁴² 12 U.S.C.A. § 1715z-1(f)(1) (West 2001).

⁴³ *Id.* § 1715(d)(5).

⁴⁴ FHA Form 1730, *supra* note 32, ¶ 4g and former 24 C.F.R. § 221.531(a) (1995).

⁴⁵ See Form Regulatory Agreement, *e.g.*, FHA Form 1730, *supra* note 32, ¶ 9e, and FHA Form 3136, *supra* note 32, ¶ 9c; HUD Handbook 4350.1, *supra* note 10, Ch. 7, App. 3 (Sept. 1992). See also *Geneva Towers Tenant Org. v. Federated Mortgage Investors*, No. C-70 104 SAW, slip op. at 6 (N.D. Cal. Jan. 3, 1972), 6 CLEARINGHOUSE REV. 96 (No. 2971, June 1972) (copy on enclosed CD).

⁴⁶ HUD Handbook 4350.1, *supra* note 10, ¶ 7-29G(2) (Sept. 1992).

⁴⁷ *Id.* at Ch. 7, App. 3.

⁴⁸ See 24 C.F.R. § 245.315(b) (2003); 24 C.F.R. § 236.55 (1994), saved by 24 C.F.R. § 236.1(c) (2003); former 24 C.F.R. §§ 221.530 and 207.19(e)(2) (1995).

⁴⁹ *Beck Park Apts. v. United States Dep't of HUD*, 695 F.2d 366 (9th Cir. 1982).

charged in light of property tax savings realized by the owner following the passage of Proposition 13's California property tax reduction.

In reviewing a rent increase proposal, issues may arise which impact rents but which are not confined to a particular income or expense item. Such issues include the difference between operating and capital expenses, return on investment for profit-motivated owners, contracts with identity of interest firms, management of multiple developments, fees for directors or officers, violations of the regulatory agreement and utility allowances and energy conservation obligations. Each of these issues is discussed below.

Capital improvements. New items or expenses for the improvement of the development should be paid for from development reserves, or development improvement funds.⁵⁰ If the reserve for replacement is inadequate and the capital improvements are necessary, they should be expensed for an appropriate period of time.⁵¹ HUD should evaluate the impact of capital improvement expenditures on rents.⁵²

If the reserve for replacement is used, the tenants may not have to pay for the new item in increased rents. In theory they have already paid for this expense through prior rents. However, in the context of approving draws from the replacement for reserve, HUD may also authorize increases in the payments to the reserve for replacement. An increased payment to the reserve for replacement will be reflected in tenants' rents. The types of items that HUD has previously listed as payable from the replacement reserve include: major appliances; interior decoration such as carpet, drapes, cabinets, doors and electrical fixtures; exterior items such as doors, screens and roofing; plumbing such as toilets, valves, fixtures and sinks; air-conditioning equipment; heating systems, hot water systems; and miscellaneous items (*e.g.*, the elevator and seal coating or resurfacing asphalt).⁵³ These items differ from those properly categorized as operating expenses, which are used to justify the overall rent levels. Operating expenses include all the items listed on the rent increase forms and include, for example: expenses for maintenance staff, insurance, common area utilities, and cleaning or repair supplies. When questions arise concerning what items should be paid for from the replacement reserves, HUD is the final arbiter. In the case of an interior repainting job, that expense generally cannot be paid for from the reserve for replacement, while exterior painting usually can. Most HUD offices have a schedule of items for which they will approve withdrawals from the replacement reserve.

Limited-dividend owners: limited return on investment. If the owner is a limited-dividend owner, there is a limitation on the return on investment. A limited dividend owner is generally allowed up to a six-percent return upon the initial investment.⁵⁴ Because a limited-dividend sponsor's mortgage is limited

⁵⁰ HUD Handbook 4350.1, *supra* note 10, ¶ 7-30.J and 4-9 (Sept. 1992).

⁵¹ *Id.* at ¶ 7-30.J(4).

⁵² *Id.* at ¶ 7-30.J.

⁵³ HUD, Flexible Subsidy Handbook 4355.1 REV-1 (May 1992) (the former edition of this handbook listed in App. 6 (Aug. 1979) the type of items to be paid out of the reserve for replacement).

⁵⁴ 12 U.S.C.A. § 1715z-1 (West 2001) and 24 C.F.R. § 236.50(a) (1994), saved by 24 C.F.R. § 236.1(c) (2003) (for Section 236 properties); 12 U.S.C.A. § 1715l(d)(3)) (West 2001) and former 24 C.F.R. § 221.532(a) (1995) (Section 221(d)(3)). *See also* Form Regulatory Agreement, *e.g.*, FHA Form 3136, *supra* note 32, ¶ 6(e)(1), and FHA Form 1730, *supra* note 32, ¶ 6(e)(1). HUD created exceptions to this limit in 2000, permitting increased distributions from owners of projects with project-based Section 8 assistance and below-market rents, if such increases are necessary to ensure continued participation of the owners in the Section 8 program. Thus, advocates must check to see if the owners have taken advantage of this "Mark-Up-To-Market" program benefit before applying the analysis within this section. 65 Fed. Reg. 61,072-01 (Oct. 13, 2000); HUD, Section 8 Renewal Policy, Guidance for the Renewal of Project-Based Section 8 Contracts (Jan. 2001). For more discussion of rent structures in HUD-

to 90 percent of the actual cost, most owners are presumed to have an equity investment of 10 percent.⁵⁵ The 6-percent return on that investment can only be paid if (1) the owner is current on the mortgage; (2) the reserve for replacement is fully funded; (3) all other development obligations are accounted for; (4) the special funds required to be maintained by the development, including tenant security deposits, are properly segregated; and (5) the development is in compliance with other outstanding requirements.⁵⁶ The owner should be in compliance with all these requirements before HUD approves a rent increase that allows for a return on investment.

In 1999 HUD responded to the growing crisis of owners “opting out” of their Section 8 contracts at expiration by issuing a notice that, for properties with both HUD-subsidized mortgages and project-based Section 8, permitted distributions beyond the six percent return ordinarily allowable under Section 236.⁵⁷ Focusing on those properties most likely to opt-out due to below-market rents,⁵⁸ the notice provided inducements to stay in the program, most importantly allowing waiver of the 6% limit in certain projects. In 2000, HUD replaced this waiver method with a final rule that permitted higher distributions for these owners.⁵⁹ Accordingly, some properties with expiring contracts and below-market rents may raise their rent levels. Contract rents for project-based Section 8 units will rise to cover the increased distributions, but rent increases for non-Section 8 tenants are specifically restricted by HUD policy.⁶⁰

Identity of interest. For all HUD-subsidized developments, HUD requires a certification from all owner-managed developments and an addendum on all management contracts regarding identity-of-interest individuals or companies.⁶¹ These requirements were imposed because of abuses by project owners and managers.⁶² The certification and addendum require that all goods and services purchased

subsidized buildings where the owners have accepted preservation or “mark up” incentives to stay in the HUD-subsidized and Section 8 programs, *see* § 15.4.2.3, *infra*.

⁵⁵ URBAN PLANNING AID, TENANTS FIRST! 17 (Boston, 1974).

⁵⁶ *See* former 24 C.F.R. §§ 221.531(b) and 236.50 (1994). *See also* Form Regulatory Agreement, *e.g.*, FHA Form No. 1730, *supra* note 32, ¶ 6, and FHA Form 3136, *supra* note 32, ¶ 6.

⁵⁷ HUD Notice H 99-15, *Emergency Initiative to Preserve Below-Market Project-Based Section 8 Multifamily Housing Stock* (June 16, 1999).

⁵⁸ Included properties were those eligible to obtain renewal rent increases up to comparable market rents (or 150% of Fair Market Rent, if lower), as permitted under the Multifamily Affordable Housing Reform and Affordability Act of 1997 (MAHRAA), Pub. L. No. 105-65, Title V, 111 Stat. 1343, 1384 (Oct. 27, 1997), *codified at* 42 U.S.C.A. § 1437f (West 2003) (Historical and Statutory Notes, “Multifamily Housing Assistance”).

⁵⁹ 24 C.F.R. § 236.2 (2003).

⁶⁰ HUD, *Section 8 Renewal Policy: Guidance for Renewal of Project-Based Section 8 Contracts*, § 3-8B (Jan. 2001). *See* §§ 15.4.2.3 and 15.4.2.4, *infra*, for more discussion of the Mark-Up-To-Market program and enhanced vouchers.

⁶¹ HUD Handbook 4350.1, *supra* note 10, Ch. 7, App. 3, Certification as to Purchasing Practices and Reasonable Expenses, ¶ 3 (Sept. 1992). *See also* *United States v. Schlesinger*, 88 F.Supp. 2d 431 (D. Md. 2000) (definition of identity of interest entity and acknowledges that Regulatory Agreement requires owner to show that identity of interest expenses were reasonable).

⁶² HUD, Office of Audit, Internal Audit of Management Agents Use of Identity-of-Interest Companies and Central Service Facilities for Multifamily Project Services, CO-99 (Sept. 11, 1979), at 2 (copy on enclosed CD).

must be at advantageous prices and that those items or services purchased from identity-of-interest individuals or companies must be at a competitive rate. In processing rent increases, HUD staff should closely review the expenses from identity-of-interest entities to be sure that they are not excessive.⁶³ The difficulty for the advocate will be to determine whether the contractor is an identity-of-interest entity. But if expenses are excessive, the HUD staff should be reminded of this obligation.

Violations of the Regulatory Agreement. HUD Handbooks provide that no rent increase request shall be approved without considering serious violations of the Regulatory Agreement, including improper maintenance. If violations of the Regulatory Agreement exist, HUD should work out an agreement with the owner before taking final action on the rent increase request. For many tenants, deteriorated project conditions are a substantial concern. Therefore, as mentioned previously, when contesting a rent increase, advocates should request a copy of the recent REAC Reports and the Management Review.⁶⁴ If there is no recent on-site inspection report, advocates could demand one before the rent increase is approved. It also may be worthwhile to obtain an inspection by the local code enforcement authorities. Tenants should also demand to participate in any negotiations or agreement reached concerning correction of the deteriorated conditions.⁶⁵

Check to see if the development has recently had deferred maintenance problems or financial difficulties and has received additional financial support or other consideration from HUD, because there may have been a plan and schedule for remedying the financial default or deferred maintenance obligations.⁶⁶ If the owner has not followed such a plan or any related schedules or commitments, that failure should be raised at the time of the rent increase request. The same course of action should be taken if the development previously received Flexible Subsidy funds which required a Management Improvement and Operating (MIO) plan.⁶⁷

Owners that are not using a HUD-approved lease are in violation of the Regulatory Agreement.⁶⁸ Thus, advocates could object to a rent increase request if the owner has not adopted a lease that complies with the HUD form.⁶⁹ Advocates should routinely check the form lease as HUD periodically amends it.

Examples of other violations of the Regulatory Agreement that advocates should consider addressing include any evidence that the owner has discriminated against applicants with children,⁷⁰ distributed any part of the 6-percent return to investors when there are outstanding notices for improper maintenance⁷¹ or

⁶³ HUD Handbook 4350.1, *supra* note 10, ¶ 7-30A(2)(d) (Sept. 1992).

⁶⁴ HUD Form 9834, *supra* note 30.

⁶⁵ *See generally* Chapter 8, *infra*.

⁶⁶ 24 C.F.R. § 886.105(d) (2003).

⁶⁷ *See* HUD Handbook 4355.1, *supra* note 53 (May 1992); HUD Handbook 4350.1, *supra* note 10, ¶ 7-29.A(5) (Sept. 1992).

⁶⁸ *See* Form Regulatory Agreement, *e.g.*, FHA Form 1730, *supra* note 32, ¶ 4e; FHA Form 1733, *supra* note 32, ¶ 4e; FHA Form 3134, *supra* note 32, ¶ 7h; FHA Form 3135, *supra* note 32, ¶ 4h; FHA Form 3136, *supra* note 32, ¶ 4h.

⁶⁹ HUD Handbook 4350.3 REV-1, app. 4-A (issued June 12, 2003, dated 5/03) (family model lease).

⁷⁰ *See* Form Regulatory Agreement, *e.g.*, FHA Form 3136, *supra* note 32, ¶ 4(j), and FHA Form 1730, *supra* note 32, ¶ 4(j).

⁷¹ *See* Form Regulatory Agreement, *e.g.*, FHA Form 3136, *supra* note 32, ¶ 6(e)(4), and FHA Form 1730, *supra* note 32, ¶ 6(e)(4).

when in default of the Regulatory Agreement, the mortgage or note;⁷² failed to maintain books and accounts in accordance with HUD regulations and in reasonable condition for a proper audit;⁷³ or, without prior written approval, charged tenants for facilities and services which were not requested by the tenants.⁷⁴

Managing multiple developments. Another common issue that advocates may confront when reviewing a rent increase request involves owners or managers that handle more than one HUD-related property. In such cases, HUD may not require budgets for all projects be submitted simultaneously. The result may be, for example, that there is one manager for three projects but the individual's salary is billed at 50 percent time for each project. The only way that an advocate can attempt to uncover this type of discrepancy is to review the prior rent increase applications for these other developments or to ask the tenants their estimate of the amount of time that the individual spends at their development and review the most recent audited financial statements of the development. These methods of course have limitations. For example, in the case of a bookkeeper, the tenants are unlikely to have any knowledge of the allocation of that employee's time. The audit report will show how much the bookkeeper was paid but not where or how she spent the time. Additionally, sometimes it is very difficult for tenants to obtain copies of the development's audited financials, which are now sent to HUD electronically. Advocates should note that HUD is required to review the HUD Field Office files on other developments managed by the owner.⁷⁵ The focus of the required inquiry, however, is on the owner's performance at the other developments. The possibility that the owner might be seeking to cover a staff person's time in an inappropriate manner in the rent request is not explicitly mentioned. Also, such a review does not help if the other developments are not federally assisted.

Fees for directors or officers. Finally, advocates should check to see whether the officers or directors of the ownership entity are receiving fees for development supervision or management. Such fees are not allowed without prior HUD approval.⁷⁶

Utility allowances and energy conservation. In the context of approving or disapproving a rent increase, HUD must now consider whether the owner could control increases in utility costs by securing more favorable rates or by undertaking energy conservation measures.⁷⁷ HUD may adjust a proposed rent increase where it is found that an owner could control utility costs.⁷⁸ If some or all utilities are paid

⁷² See Form Regulatory Agreement, e.g., FHA Form 3136, *supra* note 32, ¶ 6(e)(2), and FHA Form 1730, *supra* note 32, ¶ 6(e)(2). See also 24 C.F.R. § 886.107(g)(2) (2003).

⁷³ Former 24 C.F.R. § 221.530(e) (1994) (Section 221(d)(3) projects), also made applicable to Section 236 projects by 24 C.F.R. 236.1 (2003). See, e.g., FHA Form 3136, *supra* note 32, ¶ 9(d).

⁷⁴ See Form Regulatory Agreement, e.g., FHA Form 3136, *supra* note 32, ¶ 5, and FHA Form 1730, *supra* note 32, ¶ 5. See also Chapter 5, *infra*.

⁷⁵ HUD Handbook 4350.1, *supra* note 10, ¶ 7-29F (Sept. 1992).

⁷⁶ Former 24 C.F.R. § 221.533 (1995) (Section 221(d)(3) projects), made applicable to Section 236 projects by 24 C.F.R. § 236.1 (2003).

⁷⁷ 12 U.S.C.A. § 1715z-1a(i) (West 2001). See also 42 U.S.C.A. § 8231 (West, WESTLAW through Pub. L. No. 108-120, 2003) (authorizes funding for energy conservation for assisted projects, if conservation measures reduce tenant rents or federal subsidies); HUD Handbook 4350.1, *supra* note 10, Ch. 7, App. 3, Certification As to Purchasing Practices and Reasonableness of Expenses (Sept. 1992).

⁷⁸ 12 U.S.C.A. § 1715z-1b(a) (West 2001). This statute is applicable to the Section 236 and 221(d)(3) projects, projects with Rent Supplement units, projects with Section 8 units that were converted from Rent Supplement or

directly by tenants, owners must also submit with the rent increase request an analysis of the development's utility allowance. Data such as changes in the utility rates and other factors affecting the cost of utilities should be included in the utility analysis.⁷⁹ Ensuring proper adjustment of utility allowances is especially important for those tenants paying income-based rents.

4.3.2.2 Budget Worksheet

When all of the documents have been gathered, a good place to begin the review is with the Budget Worksheet, which provides the expenses for the prior year and a projection of expenses for the coming year.⁸⁰ When reviewing the Budget Worksheet, three initial questions need to be answered. First, are the figures in the first column, labeled "Statement of Profit and Loss," from the audited financial statement? If not, the question becomes: "Were the claimed expenses actually made?" The audit, if properly done, should answer this question. Second, were the claimed expenses necessary to the development's efficient operation? Third, was the amount of the claimed expenses reasonable? In reviewing rent increase applications, HUD assumes as a matter of course that past expenditure levels allowed were reasonable and necessary. In fact, given the inadequate nature of past reviews, this may well be an incorrect assumption. An assessment of the necessity and reasonableness of the development's claimed and projected expenses and income is the focus of the remainder of this section.

The reasonableness of line item expenditures can be evaluated in three ways. First, the expenses can be compared with past expenditures for the development. Significant increases or decreases deserve to be questioned. Second, advocates should use common sense and actual experience with the development. For example, the advocate should ask questions such as the following: Are there really three maintenance people looking after the development? Is the development getting what it is paying for in terms of lawn care, etc.? Third, the expenses may be compared with a more objective figure that represents an average of the same expenses incurred by comparable developments.

For a comparability review, HUD may have available a database for subsidized developments. Additionally, advocates may obtain comparables by checking with other apartment owners and managers in the area. In reviewing service contracts, such as elevator maintenance, janitorial services, etc., an advocate can also probably obtain other estimates of the costs.

The following is a summary of the items that contained in the Budget Worksheet, and are usually found on an annual proposed budget.⁸¹

Income (5100). In comparing the income figures on the projected budget with those for the prior year, make sure the same period of time is covered (*i.e.*, 12 months) and check the actual rent levels for the relevant periods. If there is a question about the tenant assistance payments figure, advocates can verify

Section 236 RAP, and certain property disposition projects, *see* 12 U.S.C.A. § 1715z-1a(c) (West 2001). *See also* *Clary v. Mabee*, No. 80-4024 (D. Idaho Feb. 11, 1982), *aff'd*, 709 F.2d 1307 (9th Cir. 1983) (Section 8 New Construction owner agrees to make repairs to make project more energy-efficient).

⁷⁹ Former 24 C.F.R. § 236.55(d) (Section 236), as saved by § 236.1(c) (2003) and former 24 C.F.R. § 215.45(e) (Rent Supplement) (1994); HUD Handbook 4350.1, *supra* note 10, ¶ 7-24 (Sept. 1992). *See also* § 6.3, *infra*, discussing utility allowances in Sections 236, 221(d)(3) BMIR, and Rent Supplement housing.

⁸⁰ HUD Form 92547-A, *supra* note 27, Budget Worksheet (Aug. 2000).

⁸¹ *See* HUD Handbook 4350.1, *supra* note 10, ¶¶ 7-29 and 7-30 (Sept. 1992) (providing guidance for evaluating appropriateness of development expenses). *See also* URBAN PLANNING AID, TENANTS FIRST!, App. II (Boston, 1974); M. Weitkamp, *How to Review Rent Increase Proposals for HUD-Subsidized Housing* (National Housing Law Project, Multifamily Demonstration Program, 1980) (Clearinghouse No. 29,697).

the amount by asking HUD for copies of the forms that the owner submits electronically for payments.⁸² The payment requested includes regular tenant assistance payments, as well as special claims for unpaid rent, tenant damage and vacancies.

Vacancies (5200). The Budget Worksheet now asks for the actual dollar loss attributable to vacancies.⁸³ The vacancy rate should be comparable to other similar developments. High vacancy and collection losses are often indicative of poor management. Whether due to poor maintenance and physical deterioration or poor management, tenants should be able to highlight the problem and get HUD to initiate corrective action as an alternative to a rent increase. For example, HUD could condition the rent increase on a plan that management will reduce the turnaround time between a tenant vacancy and a new tenant's occupancy. The management could also be required to keep an up-to-date waiting list, or take other steps to reduce vacancies. In addition, if vacancies are high due to evictions or tenants moving out, forfeiture of tenant security deposits should be high and the owner should be seeking reimbursement from HUD, where applicable, for vacancy loss and short fall in the security deposits within applicable program limits.⁸⁴ These security deposits are income to the development and should be used to refurbish the units. If the security deposit is not sufficient to cover the costs of refurbishing a unit, consideration should be given to recommending an increase in the amount of the deposit.⁸⁵ Also if the vacancies are due to the fact that tenants cannot afford the rent, the owner could assist families in applying for Vouchers or enter into a contract with the PHA for project based Vouchers.

Elderly and congregate service income (5300). This item refers to food services which are mandatory in some elderly developments and may be a source of great concern and cost. Food services are not subsidized, and the full cost must be borne by the resident, who may have little disposable income. Advocates should urge the owner to get the best service at the most reasonable rate and try to obtain cost comparisons from similar developments.

Financial revenue (5400). Owners are restricted to investing in government-insured instruments, which include T-notes and Bills.⁸⁶ The interest paid on these accounts will vary depending upon other financial conditions, but the mortgage lender may offer a better rate in a money market account. The Federal National Mortgage Association (FNMA), which holds many HUD-insured and -subsidized project mortgages, now permits investment of the reserve funds.

⁸² See HUD Handbook 4350.3 REV-1, ch. 9 (issued June 12, 2003, dated 5/03), a summary of the owner's monthly claims for reimbursement).

⁸³ In the past, HUD often routinely approve a vacancy factor that was larger than the actual vacancy. As a result, advocates challenged a vacancy factors that exceeded the greater of actual vacancy or 5 percent. See *Tatro v. Harris*, *supra* note 18, at 18. See also *Feir v. Carabetta Enters., Inc.*, 459 F. Supp. 841, 849 (D. Conn. 1978) (court in *dicta* explains the method used at that time by HUD to calculate vacancy losses, management fee and collection losses as flat percentage of all other expenses). See also HUD, Handbook 4350.1, *supra* note 10, Ch. 7, App. 5, ¶ 4 and Box D (Sept. 1992) (vacancy factor of 5 or 7 percent mentioned).

⁸⁴ 24 C.F.R. §§ 886.116 (Section 8 Additional Assistance) (up to one month's contract rent less security deposit); 886.315 (Section 8 Property Disposition) (2003) (up to two months' contract rent less security deposit). See also Chapter 7, *infra*, regarding security deposits.

⁸⁵ But see § 7.3, *infra*, discussing security deposits, and HUD Handbook 4350.3 REV-1, ¶ 6-15 D (issued June 12, 2003, dated 5/03) ("The amount of the security deposit established at move-in does not change when a tenant's rent changes.").

⁸⁶ All investments must be Ainsured as to principal by the United States Government." See Form Regulatory Agreement, e.g., FHA Form 1730, *supra* note 32, ¶ 2(a); FHA Form 1733, *supra* note 32, ¶ 2(a); FHA Form 3134, *supra* note 32, ¶ 4(a); FHA Form 3135, *supra* note 32, ¶ 2(a); FHA Form 3136, *supra* note 32, ¶ 2(a).

Other revenue (5900). Service income (*e.g.*, from laundry facilities or parking) usually does not vary much from year to year, unless there is a change in the nature of services provided. Usually this income is not significant, but these amounts should not be ignored.

Expenses. The following paragraphs discuss various categories of expenses.⁸⁷

Administrative expenses (6200-6300). Quite often, advocates can find questionable expenditures under this category. First, examine the total administrative expense figure to determine its reasonableness in relation to past levels. If it has increased from the past year's level, then the individual line items should be examined to find out the particular source of the increase. In addition, if the overall administrative expense level *per unit per month* is higher than other similar developments, then the breakdown should be examined further to figure out the high-cost areas.

Office salaries and expenses should rarely increase annually by more than the inflation rate. If there are any federal wage price guidelines or regulations or local living wage requirements, owners should be held to those standards. Tenants should point out any significant differences between these figures and those from developments with lower expenses, and request that HUD require the owner to justify them or disapprove any excesses. Salaries should be checked against skills, competence and services performed. Often a highly paid employee is worth the expense in terms of services performed and tenant satisfaction.

Advertising and marketing should not be a very high figure unless there are high vacancies and no waiting list. If either of these latter two situations exist, these problems need to be addressed.

The management fee is often quite troublesome and may in some cases be excessive.⁸⁸ This fee paid by the development is for the "brainpower" of the management company or individual which performs the function of overseeing development operations. HUD expects that the fee will cover all administrative expenses for frontline personnel who do not work at the development site.⁸⁹ The fee covers the cost of such items as supervision of staff, preparing budgets, training personnel, human resources management, insurance placement and risk management, recruiting, contract management, vendor relations, and hiring and overseeing project investments. The fee does not cover advertising, commissions and outside brokers, and legal and audit expenses. The fee is *not* paid to cover the day-to-day operation of the development. That function is customarily performed by an on-site resident manager who is paid separately in the property's budget.

HUD considers a management fee to be reasonable if it provides sufficient compensation to attract quality management and does not significantly exceed comparable fees charged in the same area.⁹⁰ The HUD state offices establish an acceptable management fee range. For example, HUD California State Office updated the management fee range in June 2003. The range was based upon a fixed dollar amount per unit with variations for factors such as large bedroom developments, neighborhood conditions or whether the development is troubled and whether the development serves a special clientele, such as the disabled.⁹¹ Presumably, if the rent increase request is appropriately based upon a fee supported by the HUD office, the fee will be deemed reasonable.

⁸⁷ HUD Handbook 4350.1, *supra* note 10, ¶ 7-30 (Sept. 1992) (instructions to HUD staff for evaluating the appropriateness of expenses).

⁸⁸ *Improving Controls Over Rent and Management Fees at Multifamily Housing Projects*, p. 15 (GAO/RCED-84-118, April 11, 1984) (GAO found that management fees may be excessive and concluded HUD should monitor owners to ensure that no more than approved fee is paid).

⁸⁹ See generally HUD, Management Agent Handbook 4381.5 REV-2 through CHG-2 (June 1986 - Feb. 1991).

⁹⁰ *Id.* at ¶ 3-18 (Dec. 1994).

⁹¹ HUD California State Office, Memorandum from Janet L. Browder to Multifamily Owners and Agents, *Management and Bookkeeping Fee Schedule Effective July 1, 2003* (June 10, 2003) (copy on enclosed CD).

In a rent increase situation, once the per-unit-per-month (PUPM) fee is established, that figure is then translated into a percentage of the development's rent potential. The fee's percentage of the rent potential may vary dramatically from development to development, but the PUPM fee should be similar for similar developments. The reason the percentage will vary is because, for example, it takes the same amount of management expertise to manage a similar development where tenants pay for their own utilities as where they do not. Thus, although in the rent increase context the management fee is stated in terms of a percentage of rent potential, it is determined and should be analyzed as a PUPM dollar fee.

On-site personnel are almost always hired by the management company, but their salaries are paid from development accounts, not from the management fee. Small developments (fewer than 75 units) may have a higher per unit cost for on-site managers than medium and large developments, simply because there is one manager whether the development is 50 units or 100 units. Developments located in higher-cost areas with unique management problems may legitimately require a more expensive on-site manager.

Legal expense is another item where costs can be controlled. One aspect of the inquiry into the legal expense line item is the necessity of the expenditure. If the law firm does little more for the development than send out notices for nonpayment of rent, then tenants should object to the payment of legal fees for elementary tasks that can and should be performed by the resident manager. Also, no legal fees should be charged to tenants (through increased rents) for defending owners against certain suits brought by the tenants. This is especially true if the development's legal services were necessitated by its failure to perform its legal obligations under applicable law, including the tenants' leases and the Regulatory Agreement. HUD, in the context of a manager's refusal to allow a tenant association to use the development facilities for a meeting, instructed the owner that such a position was indefensible and that any attorneys' fees or costs associated with defending such action would not be considered a reasonable or necessary operating expense.⁹² Thus, if you are contemplating a suit or defense of a suit against the project and you further believe that the law in your favor is clear, you should notify the owner and HUD that any attorneys' fees charged to the defense or pursuit of that suit should be disallowed for rent increase purposes.

Prior legal costs need to be analyzed to determine whether they included any large, one-time, nonrecurring amounts. If the expenses are nonrecurring, they should not be projected for subsequent years.

Any money recouped by the owner as a result of litigation or the threat of litigation should be reflected in income or deducted from legal expenses.

The audit expense really does not vary significantly with development size, but it should be comparable to similar developments. If substantially higher, it may be the result of the complexity of the housing and subsidy programs involved, the use of a major and expensive accounting firm, or of management's poor record-keeping. It is worth checking audit costs for comparable developments. Tenants might reasonably request that the audit contract be bid out to several firms, including smaller, local firms with HUD experience. Tenants should not have to pay rent based upon costs attributable to the management's inability to keep proper records.

Utility expenses (6400). Utility costs can vary substantially. Check the development's expenses against those for developments of similar age and design in the same climatic area. The local utility company may also have average figures available. Inordinately high costs may be due to inefficient project-supplied appliances, poor building thermal design or construction, or inadequate conservation

⁹² See Letter from Fred W. Pfaender, Dir., HUD Office of Loan Mgmt., to Andrew N. Farnese, President, Casa Fermi Bd. of Dirs., Re Project No. SH-PA-11, Casa Fermi Apts. (Apr. 28, 1978) (copy on enclosed CD).

practices.⁹³ Tenants should request HUD to require developments to correct these problems rather than saddling tenants with the expenses of ever-increasing utility bills. The owner should have developed an Energy Conservation Plan and, as part of rent increase request, is required to submit a status report on the implementation of the plan.⁹⁴ Management should not be permitted to treat utility costs as uncontrollable.⁹⁵ Possible economies in utility costs should be investigated, such as the use of bulk or “lifeline” rates, more frequent or more effective servicing of the heating system, better insulation and caulking, and greater use of storm or thermal windows, doors and screens. Utility company energy audits may be helpful here. On the question of utility rates, the owner must certify with the rent increase request that the development is receiving the lowest rates possible.⁹⁶

Operating and maintenance expenses (6500). This is an area where owners may pad the budget. Problems may also arise because supplies and materials purchased with development funds may be taken by on-site personnel or used for other properties.

Pest control and garbage collection expenses will vary significantly from development to development. Compare the expense to that incurred by a similar development in the area. In addition, evaluate the figure in light of the quality of the service being provided.

Protection or security expenses are a major cost of many subsidized housing developments. If incurred, they should be supported by a contract. Confirm with the residents that the expenses are necessary and appropriate, considering the type and location of the development, as well as the nature of its security problems. Expenses for security personnel should be weighed against structural improvements that also may improve security, such as neighborhood watch programs, fences, video-cameras, window bars and locks, good lighting, and a central security system limiting or monitoring access to the building.

Expenses for the upkeep of the grounds, repairs, cleaning, and decorating should be closely scrutinized in relation to the actual physical condition of the development. First-hand tenant reports, code inspections, REAC Physical Inspection Summary Reports and Management Review reports,⁹⁷ and an on-site inspection will be indispensable to a thorough analysis of these figures.

An overall per-unit-per-month figure for maintenance expenses that differs significantly from that for similar developments in the area may indicate chronic vandalism, poor management or poor design and shoddy construction or repair work. A higher figure should be questioned and examined by line item.

Upkeep of the grounds is sometimes contracted out to a private firm.⁹⁸ If so, determine if competitive bids were requested. Neither the contract price nor the expenses for supplies (if not included in the contract) should increase substantially from year to year. If one of these items does, check to see whether it is legitimately explained by additional costs or efforts and results. If the contract for services includes supplies, then there should be no other significant supply expense.

Ordinary repairs may be made by on-site maintenance personnel, by private entities under contract, or a combination of both. Examine both the total figure for all repairs and the expense figures for on-site payroll, contract work, and supplies. If the total repair figure is high in relation to similar developments in

⁹³ S. Ferrey, *Energy Needs of the Poor: A Saga of Ongoing Legislative Neglect and Local Abuse*, 11 CLEARINGHOUSE REV. 331, 333 n.19 (Aug. 1977). See also S. Ferrey, *The Ghosts of Cold November: An Examination of HUD's Energy Conservation Policy for the Poor*, 11 CLEARINGHOUSE REV. 1 (May 1977).

⁹⁴ HUD Handbook 4350.1, *supra* note 10, ¶¶ 7-22.F and 12 (Sept. 1992).

⁹⁵ See § 6.2.5, *infra* (discussing conservation practices and energy audits in Public Housing).

⁹⁶ HUD Handbook 4350.1, *supra* note 10, Ch. 7, App. 3 (Sept. 1992).

⁹⁷ See HUD Form 9822, *supra* note 29, and HUD Form 9834, *supra* note 30.

⁹⁸ See also the discussion at § 4.3.2.1, concerning identity-of-interest firms.

the area, the development could be either overspending or paying the price for poor tenant selection, inferior quality design or shoddy construction. On-site personnel may not be performing an adequate job, contract work rates may be high, or perhaps a lot of work is needed to pay for deferred maintenance.

Redecorating expenses may be broken out separately. Many HUD offices require a schedule under which a certain percentage of units are redecorated annually. Without a required schedule, managers may redecorate only when the unit is vacated or when the tenants protest loudly enough. The cost of redecoration will depend upon the nature of the tenant's use and the quality of supplies. Check to be sure that the redecoration is in fact being done.

Extraordinary repairs or one-time rehabilitation may be included in the owner's operating budget. Tenants should insist that these cost come from the reserve fund for replacements, which is specifically designed for such purposes.⁹⁹ Other potential sources of funds include the residual receipts account, if any, and for cooperatives the General Operating Reserve (GOR).¹⁰⁰ If the reserves are inadequate to cover the cost of needed repairs, tenants should work with the owners to identify other sources of funding. Owners of older buildings often seek rehabilitation grants or loans from local government through the HOME program, Community Development Block Grant (CDBG) funds or other sources. Nonprofit owners may well be able to secure loans which may be forgiven, while for-profit owners will generally have to find a way to repay them, either through surplus cash, if any, or by convincing HUD to increase the project-based Section 8 rents.

Taxes and insurance (6700). A few owners continue to erroneously believe that they have no control over property taxes. Owners should be urged to seek an adjustment in the tax assessment, a tax abatement or other tax relief. The owner must certify to HUD that the development has received or requested tax relief for which it is eligible.¹⁰¹

Challenging the property taxes may be time consuming and costly. Nevertheless, it may be worthwhile to take at least a few preliminary steps to reduce the tax assessment. Often, merely requesting an explanation of the assessment will result in a reduction. In addition in some cases, there are firms that will seek a tax abatement and charge on a contingent fee a percentage of the savings. Finally, you should be aware that some states have special tax benefits for nonprofit or elderly developments.¹⁰²

Insurance covers the development both for damage due to fire, vandalism, etc., and for liability for personal injuries incurred on the premises. Insurance premiums can fluctuate dramatically over time, and recently have increased dramatically nationwide. The costs for a development will vary depending on a variety of factors including the type of construction, the neighborhood, and the number of claims being made. Some owners maintain high deductibles and do not insure for small amounts of damage resulting from fires or vandalism, to avoid a prohibitive increase in rates or cancellation of a policy. Comparable costs may be obtained from an insurance agent who specializes in insuring government-assisted properties. Advocates should ask HUD to make the owner show that the rate is a favorable one.

In addition to property and liability insurance, the workers' compensation insurance expense needs to be examined. Rates have also increased significantly for this kind of insurance recently. However, high

⁹⁹ See the discussion concerning capital improvements at § 4.3.2.1, and the discussion in this section on other cash requirements.

¹⁰⁰ See discussion of these funds in □ 4.3.2.2, *infra*.

¹⁰¹ HUD Handbook 4350.1, *supra* note 10, Ch. 7, App. 3 (Sept. 1992).

¹⁰² See Cal. Rev. & Tax Code § 236 (West, WESTLAW through ch. 2 of 2002 Reg. Sess. urgency legislation & ch. 1 of 3rd Ex. Sess. (2002)). See also M. Smith, *Property Taxation of Federally Subsidized Housing in California* (National Housing Law Project, Multifamily Demonstration Program, Working Draft Submission, Oct. 1, 1977). *But see Little Earth of United Tribes v. County of Hennepin*, 384 N.W.2d 435 (Minn. Super. Ct. 1986) (Indian housing project does not qualify for state tax exemption).

rates can also be due to a bad claims history and improper categorizing of jobs. It can also be worthwhile exploring whether the owner has received any rebates for *good* claims experience; any rebates are required to be reimbursed to the development, not retained by the owner or manager.

To the extent that salaries for on-site personnel are increased or reduced, payroll taxes will also increase or decrease. Unemployment insurance, worker's compensation, and FICA often amount to more than 15 percent of the development's payroll. Health insurance coverage is also a high, but necessary expense for development employees.

Financial expenses (6800). This item includes the interest component of the mortgage payment for the project. For most developments, this is one expense that remains constant or that decreases slightly from year to year. For Section 236 projects, there is also a required mortgage insurance premium. Additionally, the cost of servicing any secondary financing will be shown here. It is very important, in reviewing accrual-based financial statements, to determine whether payments owed for secondary financing are actually being made, or are just being accrued without an actual cash outlay, since they can dramatically affect the bottom line.

Other Cash Requirements. At the end of the Budget Worksheet, there is space for information regarding the reserve for replacement payments and for cooperatives, the payments to the General Operating Reserve. In addition, information on principal payments and debt service for other loans is required.

Depreciation. There is no information requested regarding depreciation on the Budget Worksheet, as it involves no cash outlay and therefore should never be included in the operating budget. Its function is solely limited to income tax purposes. The owner should not attempt to use depreciation to justify a rent increase and HUD should not acquiesce to any such request. The services of an accountant or real estate consultant should be used to challenge any claim that depreciation may be used to justify a rent increase.