



# Federal Register

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**Thursday,  
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**Part II**

## **Department of Housing and Urban Development**

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**24 CFR Parts 401 and 402**

**Renewal of Expiring Section 8 Project-  
Based Assistance Contracts; Final Rule**

**DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**24 CFR Parts 401 and 402**

[Docket No. FR-4551-F-01]

RIN 2502-AH47

**Renewal of Expiring Section 8 Project-  
Based Assistance Contracts**

**AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

**ACTION:** Final rule.

**SUMMARY:** This final rule governs renewal of Section 8 project-based assistance contracts, except renewal as part of a restructuring plan (Restructuring Plan) in the Mark-to-Market program. Currently, contracts are being renewed under the authority of an interim rule that became effective October 11, 1998, and later statutory changes.

**EFFECTIVE DATE:** February 13, 2006.

**FOR FURTHER INFORMATION CONTACT:**

Willie Spearmon, Director, Office of Housing Assistance and Grant Administration, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410-8000, telephone (202) 708-3000. (This is not a toll-free number.) For hearing- and speech-impaired persons, this number may be accessed through TTY by calling the toll-free 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 the Multifamily Assisted Housing Reform and Affordability Act of 1997, 42 U.S.C. 1437f note (MAHRA). Except for section 524, these subtitles apply to the Mark-to-Market program for restructuring debt and rental assistance. The interim rule implemented section 524 of MAHRA in a new 24 CFR part 402. Other sections of MAHRA were implemented in a new 24 CFR part 401. HUD issued part 401 as a final rule on March 22, 2000 (65 FR 15452). Some related changes to §§ 402.1, 402.4, and 402.6 were included in that 2000 final rule, but those sections are updated further in this final rule. The preamble to the 2000 final rule stated that further changes would be made to § 402.4(a)(2) based on the comments received in response to the interim rule (see 65 FR 15476). This final rule includes those further changes. HUD issued corrections to the

part 401 final rule on September 6, 2000 (65 FR 53899).

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

Section 524 of MAHRA and the regulations in 24 CFR part 402 authorize renewal of expiring or terminating Section 8 project-based assistance contracts for projects without Restructuring Plans under the Mark-to-Market program, including (1) projects that are not eligible for Restructuring Plans or are otherwise exempt, and (2) eligible projects for which the owners request contract renewals without Restructuring Plans. Part 402 does not apply to the project-based certificate or voucher program, which operates under different statutory authority.

HUD's Office of Housing has provided guidance for contract renewals under section 524, other than for moderate rehabilitation contracts. This guidance was originally provided through various notices including Office of Housing Notices H 98-34, H 99-15, H 99-36, and H 2000-12, issued on May 27, June 16, and December 29, 1999, and June 29, 2000, respectively, and currently through the Section 8 Renewal Policy Guidebook (Office of Multifamily Housing, 2001), which supersedes these prior Housing notices. The interim rule made HUD's Office of Public and Indian Housing responsible for issuing separate guidance on contract renewals under part 402 of the interim rule for non-Single-Room Occupancy (SRO) moderate rehabilitation projects. That guidance was issued on December 15, 1998, as Office of Public and Indian Housing (PIH) Notice PIH 98-62, which was clarified and extended by Notice PIH 99-22, issued May 20, 1999, and Notice PIH 2001-13, issued April 6, 2001. Notice PIH 2000-9 was issued on March 7, 2000, on the related subject of enhanced vouchers and was superseded by Notice PIH 2001-41, issued November 14, 2001.

After the interim rule was issued, Congress enacted two laws that amended certain MAHRA provisions that had been implemented in the part 402 interim rule. These laws are 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). One change to part 402 that implemented a provision of Public Law 105-276 was made by a technical

correction rule published December 28, 1998 (63 FR 71372). Other changes needed to implement Public Law 105-276, and the changes needed to implement Public Law 106-74, are now included, to the extent possible, in this final rule. These changes are discussed in section V of this preamble. 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 Public Law 106-74, and the provisions of section 522 of MAHRA. A detailed discussion of how HUD has reconciled these requirements was published in the preamble to the final part 402 rule published on March 22, 2000 (65 FR 15453).

On January 12, 2002, Congress enacted the Mark-to-Market Extension Act of 2001, Public Law 107-116. Most of the provisions of that act will be implemented in a separate rulemaking. However, this rule modifies the definition of "eligible project" in 24 CFR 401.100 to include the statutory provision for look-back projects in section 612(f) of the Mark-to-Market Extension Act of 2001. In addition, because that law provided that the Office of Multifamily Housing Assistance Restructuring (OMHAR) and the position of Director of OMHAR were terminated "at the end of September 30, 2004," and their functions transferred to the Secretary of HUD, this rule removes the terms "OMHAR" and references to the Director of OMHAR.

This final rule is based on HUD's consideration of public comments received on the interim rule of September 11, 1998, HUD's experience to date with renewals of contracts, and certain provisions in Public Law 105-276, Public Law 106-74, and Public Law 107-116, as noted above. In addition to this final rule, a related proposed rule is being published in today's **Federal Register**.

**II. Comments Received on Part 402**

The interim rule of September 11, 1998, added two new parts to title 24 of the Code of Federal Regulations. HUD received 61 comments, but five comments were not pertinent to the interim rule. The majority of the other comments related solely to part 401 and were discussed in the preamble to the 2000 final rule. The discussion in this section of the preamble summarizes comments related to part 402 and HUD's responses to the comments. In this section of the preamble, the regulatory sections of part 402 are grouped into major areas of related subject matter as shown in the outline below. The

discussion of the comments is presented in the order in which the areas are first covered in part 402. Regulatory sections that received no public comments are not included.

*A. Section 402.1 What Is the Purpose of Part 402?*

1. Projects previously restructured under MAHRA and under prior restructuring authority.
2. Section 405(a) of the Balanced Budget Downpayment Act.

*B. Section 402.3 Contract Provisions*

*C. Section 402.4 Contract Renewals at or Below Comparable Market Rents Without Restructuring (Former Section 524(a)(1) of MAHRA, Now Section 524(a))*

1. Marking up to market.
2. Other comments on renewals for below-market projects.
3. Using budget-basing for determining or adjusting rents.
4. Preservation projects.
5. Extent of HUD discretion to renew.
6. Bond funding.
7. Determination of Operating Cost Adjustment Factor (OCAF).
8. Negative OCAF.
9. Appeals of OCAF.
10. Tenant participation.

*D. Section 402.5 Contract Renewals for Projects Eligible for Exception Rents*

1. Expenses to be considered in budget-basing.
2. Preservation projects.
3. Adjust through budget-basing or OCAF?
4. Who confirms owner's rent determination?

*E. Section 402.6 What Actions Must an Owner Take To Request Contract Renewal Under Part 402?*

*F. Section 402.7 Rejection of Owner*

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

*G. Section 402.8 Tenant Protection if a Contract Is Not Renewed*

1. Is tenant-based assistance mandatory?
2. When is notice required?
3. Rent levels for tenant-based assistance.
4. Timing of tenant-based assistance.

### III. Discussion of Comments

*A. Section 402.1 What Is the Purpose of Part 402?*

*Summary of section:* This regulatory section sets out the terms and conditions for part 402 under which

HUD will renew project-based Section 8 contracts under section 524 of MAHRA without a Restructuring Plan under the Mark-to-Market program under part 401.

*Summary of comments:*

1. *Projects previously restructured under MAHRA and under prior restructuring authority.*

*Comment:* Three commenters wanted HUD to clarify that part 402 does not cover contract renewals for projects that have been through restructuring (either as a part of a demonstration or under part 401).

*HUD response:* As indicated in § 402.1 and in the preamble to both the implementing 1998 rule and the 2000 final rule, section 524 of MAHRA (and the corresponding regulations in part 402) applies only to the renewal of project-based Section 8 contracts without Restructuring Plans under the Mark-to-Market program. HUD therefore agrees that part 402 does not apply to contract renewals for projects that have been restructured under MAHRA. While § 402.5(d)(2) applies to demonstration projects for which HUD made a determination that debt restructuring is inappropriate and the owner of the project executed a Portfolio Reengineering Demonstration Program Use Agreement, nothing else in part 402 applies to projects that completed the Portfolio Reengineering Demonstration Program and executed a recorded Portfolio Reengineering Demonstration Program Use Agreement.

2. *Section 405(a) of the Balanced Budget Downpayment Act.*

*Comment:* Part 402 should address HUD's continuing authority to renew Section 8 contracts under section 405(a) of the Balanced Budget Downpayment Act (Pub. L. 104-99). Section 405(a) was suggested as a solution for contract renewals for section 236 budget-based projects.

*HUD response:* Part 402 is concerned only with renewals authorized by MAHRA.

*B. Section 402.3 Contract Provisions*

*Summary of section:* This regulatory section provides that contracts renewed under part 402 will be administered in accordance with all HUD regulations and requirements, including changes in HUD's regulations and requirements during the term of the renewal contract.

*Summary of comments:*

*Comment.* One commenter wanted an explanation of the provision which the commenter thought was unclear. The commenter asked whether the rule referred only to regulations not required by Section 8, and whether HUD intended the contract to substitute for regulations governing management and

operations of projects under renewed project-based assistance contracts.

*HUD response:* HUD has revised this regulatory section in order to provide clarification. The section now reads that HUD's regulations apply to the Housing Assistance Payment (HAP) contract, unless the contract specifies otherwise.

*C. Section 402.4 Contract Renewals Under Section 524(a) of MAHRA (Renewal at or Below Comparable Market Rents)*

*Summary of section:* This regulatory section implements section 524(a) of MAHRA for projects other than projects eligible for exception rents. It achieves this by authorizing contract renewal without restructuring at rents that do not exceed comparable market rents. If the project is eligible for the Mark-to-Market program under the authority of section 512(2) of MAHRA and 24 CFR part 401, the owner's request for contract renewal will be processed under § 402.4(a)(2) (§ 401.601 of the interim rule) to determine whether a Restructuring Plan is needed.

*Summary of comments:*

1. *Marking up to market.*

*Comment:* The interim rule did not specifically address the possibility of "marking up to market," i.e., renewing a contract for which existing rents are below comparable market rents at higher rents (up to comparable market rents). Many commenters thought the final rule should specifically permit marking up to market, at least in some situations, in order to preserve affordable housing stock that could not be operated or maintained in a satisfactory condition at existing rents.

*HUD response:* HUD's policy on "marking up" for 1999 was stated originally in Office of Housing Notice H 99-15 issued on June 16, 1999. That policy permitted "marking up" for some projects with comparable market rents at least equal to 110 percent of the Fair Market Rent (FMR) under procedures and requirements stated in the Guidebook. Renewal rents were limited to the lesser of comparable market rent or 150 percent of the FMR. The policy on "marking up" is now contained in Chapter 3 of the Section 8 Renewal Policy Guidebook.

Public Law 106-74 amended section 524 to mandate marking up of below-market rents in some cases, while permitting it at HUD's discretion in other cases. The amended section 524 applies to renewal of contracts expiring on October 1, 1999, or later. HUD issued Office of Housing Notice H 99-36 (also superseded by the Section 8 Renewal Policy Guidebook) on December 29, 1999, to implement its "marking up"

policy carrying out the amended law for Fiscal Year (FY) 2000.

2. *Other comments on renewals of below-market projects.*

*Comment.* Two commenters stated that the initial renewal under § 402.4 for projects at existing below-market rents should be at existing rents plus an operating cost adjustment factor (OCAF), as with projects eligible for exception rents (other than non-Single Room Occupancy (SRO) moderate rehabilitation projects) under § 402.5. Two commenters stated that it was necessary to clarify in the final rule that renewal rents would be no less than existing below-market rents with no downward adjustment.

*HUD response:* For projects that are not eligible for exception rents, renewal rents under § 402.4 will be in accordance with the specific statutory directions of section 524(a)(4) of MAHRA. In some cases, HUD does not have discretion to set the rent level; in others, there is a permitted range.

Specific instructions are provided in the statute for setting renewal rents for contracts for projects eligible for exception rents renewed pursuant to § 402.5. Renewal rents for these projects will be the lesser of the existing project rent adjusted by an OCAF or a level that provides income sufficient to support a budget-based rent that is justified by reasonable and expected operating expenses, except for non-SRO moderate rehabilitation contracts that are subject to other requirements, as stated in § 402.5(b)(3).

3. *Using budget-basing for determining or adjusting rents.*

*Comment:* Some commenters expressed concern over the possibility of budget-based adjustments to reduce rents instead of using OCAF. One commenter said that if HUD has doubts about the accuracy of rents based on OCAF, then HUD should conduct a new market analysis. Five commenters did not want HUD to use OCAF if budget-basing resulted in higher rents needed to operate viable projects. Some other commenters encouraged the use of budget-based adjustments. Five commenters argued that projects that historically received budget-based rents (section 202 and section 236 projects) should continue to get them if they are below comparable market rents.

*HUD response:* Rents under contracts initially renewed pursuant to section 524(a) of MAHRA (§ 402.4) will be adjusted by OCAF or a budget-based method. Owners that request contract renewal for projects eligible for exception rents under section 524(b)(1) of MAHRA (other than non-SRO moderate rehabilitation projects) under

§ 402.5 will have their contracts renewed at rents that are the lesser of the current rent adjusted by an OCAF or the budget-based rent, as required by the statute. The Department has no flexibility with rents for contracts for projects renewed pursuant to section 524(b)(1) of the amended law.

4. *Preservation projects.*

*Comment:* Four commenters said HUD should clarify in the final rule that rents for preservation projects under the Low-Income Housing Preservation and Resident Homeownership Act (LIHPRHA) and the Emergency Low-Income Housing Preservation Act (ELIHPA) will be set as needed (including marking up to market and using either budget-based adjustments or OCAF) to honor HUD commitments in Plans of Action. (See also section II.D.2. of this preamble).

*HUD response:* Although the statutory provisions in effect when the interim rule was issued did not authorize HUD to treat every preservation project with an approved plan of action as an exception, such treatment is now required by statute, and HUD must provide benefits comparable to those in the plan of action to the extent amounts are specifically made available in appropriations acts (as they have been for FY 2000, FY 2001, and FY 2002).

5. *HUD discretion to renew.*

*Comment:* Two commenters wanted renewal requested by owners of eligible projects to be mandatory rather than discretionary with HUD. If renewal will not be mandatory, two commenters wanted the final rule to indicate HUD's basis for decisions not to renew, with one commenter requesting an express preference for projects to be sold to priority purchasers. One commenter wanted the final rule to clarify that an owner may request renewal for less than all units covered by an expiring contract in order to pursue a mixed-income project option, with tenant-based assistance available for tenants of units not covered by project-based assistance.

*HUD response:* As amended by Public Law 106-74, section 531 and sections 524(a)(1) and (a)(2) of MAHRA require HUD, at the request of the owner, to renew an expiring Section 8 contract, with two exceptions. Section 524(a)(1) does not require contract renewal for an eligible project without a Restructuring Plan if HUD determines that a plan is necessary. Section 524(a)(2) does not require contract renewal for "bad" owners or projects under section 516(a) of MAHRA. Therefore, renewal in these particular cases would not be mandatory. In cases where renewal is required, the statute does not afford an option not to renew certain units

because a mixed-income project is pending. As to the comments that the rule should require HUD to provide a reason for a non-renewal, the existing due process protections in the rule (see § 402.7(b)) are sufficient. Therefore, no change has been made as a result of these comments.

6. *Bond funding.*

*Comment:* A commenter asserted that the interim rule would cause bond defaults for projects renewed under § 402.4 or § 402.5, because the rents allowed will not permit a project to meet the debt service coverage required by bond documents.

*HUD response:* HUD disagrees with this comment. Projects eligible for exception rents under § 402.5 in the final rule continue to include projects with primary financing provided by a unit of state or general local government, if Mark-to-Market restructuring would conflict with applicable law or agreements governing such financing. Some bond-funded projects are therefore still eligible for renewal under § 402.5 (limited by the lesser of existing rents adjusted by OCAF or a budget-based rent). Thus, unless the project is unable to meet debt service at existing rents and is already in default, there is no circumstance in which the Section 8 renewal policies reflected in the regulations would result in default for bond-funded projects that continue to qualify as exception rent projects under § 402.5.

As a result of Public Law 106-74, many projects financed with bond funding that previously would have received contract renewal under § 402.5(b) are now eligible for renewal either under § 402.4 or through Mark-to-Market restructuring if the project has an insured mortgage and above-market rent levels. A bond-funded project (or a project that otherwise has state or local government financing) will be reviewed initially by HUD to determine whether the project is eligible or ineligible for Mark-to-Market restructuring and ensure that renewals for such projects are not improperly processed under § 402.5. If the requirements for processing under § 402.5(b) are not met (e.g., because restructuring would not conflict with any law or financing agreement), HUD would then proceed under § 402.4(a)(2) to determine whether renewal under § 402.4 would provide sufficient rental income for a viable project. That determination would include consideration of bond requirements concerning debt service coverage. If renewal under § 402.4 would force violation of those requirements, HUD could require restructuring under the Mark-to-Market

program (reducing current debt service charges) as a condition of contract renewal.

#### 7. Determination of OCAF.

*Comment:* 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 projects insured by the Federal Housing Administration (FHA) showed that their expenses could be grouped into nine categories—wages, employee benefits, property taxes, insurance, supplies and equipment, fuel oil, electricity, natural gas, and 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. Projects may apply for a budget-based rent review in the presumably unusual case in which the application of the OCAF does not address unexpected project specific fluctuations.

*Comment: 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, thereby requiring some other means to boost rents. Another said the exclusion will decrease attractiveness of the project to investors who want to increase their debt service coverage over time.

*HUD response:* Congress’ use of the term 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. Since the interest rate is expected to remain constant, 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.

#### 8. Negative OCAF.

*Comment:* 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:* HUD will comply with statutory changes to MAHRA made by Public Law 106–74 that prohibit using negative OCAF when determining rent levels.

#### 9. Appeals of OCAF.

*Comment:* 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 generally used for rent adjustments, but HUD retains the discretion to use a budget-based rent adjustment instead. 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 cost items and should prove adequate in most projects. If rent adjustments through use of OCAF are inadequate, however, budget-based review would provide the most relevant basis for reviewing the adequacy of overall project funding.

#### 10. Tenant participation.

*Comment:* 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:* While tenant involvement is required by statute in the Mark-to-Market restructuring process, there is no such requirement for tenant involvement in other contract renewal decisions, although HUD strongly recommends such tenant involvement. For projects eligible for restructuring, see § 401.502 of part 401, which guarantees notice and an opportunity to comment for tenants whenever an owner requests contract renewal without restructuring.

#### D. Section 402.5 Contract Renewals for Projects Eligible for Exception Rents

*Summary of section:* This section concerns renewals under section 524(b)(1) and (3) of MAHRA (formerly

section 524(a)(2)) for projects that are entitled to exception rents and are ineligible for, or otherwise exempt from, restructuring under part 401. These include certain projects financed by state or local governments, certain elderly projects, SRO projects, and projects ineligible because they do not have rents exceeding comparable market rents or because there is no FHA-insured or HUD-held mortgage. The owner of a project that is ineligible solely because rents are not above market may renew under § 402.5 only if HUD confirms the fact that the rents are at or below market. Contract renewals for projects under section 524(b)(1) of MAHRA are at the lesser of existing rents adjusted by an OCAF or a budget-based rent determined according to instructions issued by HUD’s Office of Housing. In the case of a contract for a non-SRO moderate rehabilitation project, section 524(b)(3) of MAHRA provides for rents at the least of existing rents adjusted by an OCAF, fair market rents (less any amounts for tenant-purchased utilities), or comparable market rents. For such a project, future rent adjustments are also governed by section 524(b)(3).

#### Summary of comments:

##### 1. Expenses to be considered in budget-basing.

*Comment:* Commenters asked that the budget include:

- An owner’s rate of return regardless of whether it is separately included in budget-basing under part 401 (one commenter).
- Health and social services for elderly/handicapped projects (one commenter).
- Actual current interest rates on debt rather than rates adjusted to reflect the current market (two commenters).

*HUD response:* The rule does not dictate the specific components of a budget. It should be noted, however, that HAP payments may be used to cover rent, as defined, but not additional costs, such as food, health, and social services costs.

##### 2. Preservation projects.

*Comment:* Three commenters wanted all preservation projects with expiring contracts treated as “exception projects,” with rents determined to permit commitments in the Plan of Action to be honored.

*HUD response:* Please see the HUD response in Section III.C.4 of this preamble.

##### 3. Adjust through budget-basing or OCAF?

*Comment:* Three commenters said that budget-basing should be used to raise rents for projects under section 524(b)(1) of MAHRA whenever OCAF

results in income inadequate to operate a project. Another commenter wanted the final rule to clarify that a contract initially renewed under budget-based rents will continue to be renewed in that manner. Another commenter questioned the mention of a comparability analysis in § 402.5(d) of the September 11, 1998, interim rule and objected if it meant that HUD will hold rents to market for projects eligible for exception rents.

*HUD response:* The commenter expressed concern that the current rent adjusted by the OCAF would be inadequate to continue operating the project. Renewal contracts for projects under section 524(b)(1) of MAHRA will have their rents established under the final rule at the lesser of the OCAF-adjusted current rent or the budget-based rent in accordance with statutory requirements. If current rent adjusted by the OCAF is insufficient to cover the project's operating costs in the future, HUD will consider a budget-based increase at the request of an owner.

The Department does not agree with the commenter's request that any contract initially renewed under budget-based rents must continue to be adjusted in that manner. As amended by Public Law 106-74, section 524(c) of MAHRA clearly requires budget-basing for rent adjustments after the initial renewal to be "subject to the approval of the Secretary." In addition, at the expiration of each 5-year period of the renewal contract term, HUD conducts a comparability study by comparing existing rents with comparable market rents in the area and may make adjustments as necessary, either to maintain the contract rents at a level no greater than comparable rents, or to increase the contract rents to comparable market rents. This comparability requirement is stated at 24 CFR 402.4(b)(2) of the separate proposed rule being published in today's **Federal Register**. The OCAF adjustments that are available in subsequent years require considerably less paperwork by the project owner and by HUD. The rule does not preclude the use of a special budget-based rent increase, where warranted.

#### 4. Who confirms owner's rent determination?

*Comment:* One commenter wanted the final rule to clarify that the Participating Administrative Entity (PAE), and not HUD, confirms an owner's determination that a project qualifies as a project entitled to exception rents under § 402.5 due to below-market rents.

*HUD response:* HUD's Office of Housing or its contract administrator,

rather than the PAE, will make the determination.

#### E. Section 402.6 What Actions Must an Owner Take To Request Contract Renewal Under This Part?

*Summary of section:* Section 402.6 provides a procedure for requesting contract renewal under part 402. The owner submits to HUD (or the contract administrator) required information, which includes: (1) A certification that the owner is not suspended or debarred; (2) a rent comparability study (not required for most projects entitled to exception rents); and (3) if the owner of a project eligible for Mark-to-Market restructuring under part 401 is instead seeking renewal under § 402.4, the most recent annual audited financial statement for the project, and the owner's evaluation of physical needs complying with § 401.450. (The final rule generally provides for submission of documents and information prescribed by HUD, but no longer lists these specific items.) Separate instructions are issued for renewal of moderate rehabilitation contracts.

#### *Summary of comments:*

*Comment:* One commenter asked HUD to clarify any differences in submission requirements between above- and below-market projects. Another commenter questioned the need to require financial statements and owners' evaluation of physical condition from an owner of a project eligible for exception rents (and thus entitled to renew under § 402.5) who chooses to renew under § 402.4 instead. This commenter noted that financial statements for a fiscal year often are not available until 60 days after year-end and thus may be unavailable when the renewal request is submitted.

*HUD response:* The most recently required financial statement should be provided. If the renewal request and expiration is within the 90-day period following the end of the project's fiscal year, the previous year's statement will be accepted. Financial statements and owners' evaluations of physical condition are not required if a project entitled to exception rents under section 524(b)(1) of MAHRA renews under § 402.4. These documents should be submitted only for projects that are eligible for a Restructuring Plan, and for which the owners have instead requested renewal under § 402.4. It is not appropriate to include in the final rule additional information for the submission requirements for above- and below-market properties. The Department has published this information in numerous Housing

Notices and, more recently, the Section 8 Renewal Policy Guidebook.

#### F. Section 402.7 Rejection of Owner

*Summary of section:* This section implements section 516(a) of MAHRA, which permits HUD to elect not to consider a request for contract renewal on the basis of certain actions or omissions by an owner or purchaser of the project or an affiliate. (That MAHRA provision is also implemented through several sections in part 401.) HUD may elect not to consider a renewal request if, among other things, (1) the owner or an affiliate is debarred or suspended by HUD, or (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 (these 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. A rejection under this section is subject to administrative review as provided in part 401, subpart F.

#### *Summary of comments:*

##### 1. Designation as "bad" owner.

*Comment:* Two commenters argued that HUD should not reject an owner for a suspension/debarment if the owner's appeal is not yet adjudicated. One of these commenters also objected to basing a "bad owner" rejection on an LDP or proposed debarment alone because such actions might not be "material" within the meaning of section 516(a) of MAHRA.

*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. HUD or PHAs are required to make a determination of materiality if a debarment or suspension decision has not already been made by the Department.

##### 2. Treatment of civil rights violations.

*Comment:* 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 the appropriate HUD Assistant Secretary after consultation with HUD's Office of Fair Housing and Equal Opportunity. Under this final rule, HUD requires owners requesting restructuring and/or contract renewal to certify compliance with

HUD's non-discrimination requirements at 24 CFR 5.105(a).

3. *Project transfers to "good" owners.*

*Comment:* Four commenters thought that the rule was deficient in its treatment of project transfers after "bad owner" determinations. One labeled 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 transfers to priority purchasers are preferable to conversion. Two others cited a Senate floor statement regarding the need for HUD to develop alternative solutions for projects when an owner is disqualified.

*HUD response:* The Department is committed to protecting tenants living in assisted units. The determination not to renew the project-based assistance will be made on a case-by-case basis. HUD will consider the best interests of the tenants, the potential to transfer the project to priority purchasers, and other remedies.

4. *"Uncooperative" owners.*

*Comment:* 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 and who thereby is found ineligible for a restructuring plan under 24 CFR 401.402 will not become ineligible under § 402.7 for contract renewal without restructuring.

*HUD response:* HUD will make a case-by-case determination of whether or not to renew a Section 8 contract with rents reduced to market should the owner of an eligible project be unwilling to cooperate with debt restructuring under part 401.

G. *Section 402.8 Tenant Protection if a Contract Is Not Renewed*

*Summary of section:*

The owner is not required to renew a contract, but the owner must give one-year advance notice of contract termination as required by Section 8(c)(8)(A) of the United States Housing Act of 1937 (42 U.S.C. 1437f(c)(8)(A)). (Note that the underlying statutory provision has changed since the interim rule took effect.) This section of the final rule provides that an owner who does not give the timely notice must continue to permit tenants to stay in their units without increasing the tenant portion of the rent for one year after notice is given.

*Summary of comments:*

1. *Is tenant-based assistance mandatory?*

*Comment:* Interim part 402 did not address the availability of tenant-based assistance if an owner of a project ineligible for restructuring under part 401 chose not to renew under part 402 (i.e., the owner "opts out"). Many commenters wanted the matter addressed. Two commenters argued that tenant-based assistance should be guaranteed if the owner is rejected. One commenter wanted tenant-based assistance to be guaranteed in all termination situations, while another felt that HUD needed to give reasons if this was not done. Finally, one commenter asked HUD to make clear in the rule that HUD expects appropriations for tenant-based assistance to protect displaced tenants.

*HUD response:* Section 524(d) of MAHRA provides for enhanced vouchers to eligible tenants of assisted units in projects if the Section 8 project-based assistance is not renewed under sections 524(a) or (b), or "any other authority," to the extent that appropriated funds are available for that purpose.

2. *When is notice required?*

*Comment:* Three commenters said that a failure to renew because HUD found the owner ineligible for contract renewal should not require a notice to tenants. Two others wanted tenant notice in all opt-out or other termination situations, including owner ineligibility.

*HUD response:* There is no statutory exception for ineligible owners to the one-year termination notice requirement, so HUD cannot provide one in this rule.

3. *Rent levels for tenant-based assistance.*

*Comment:* One commenter questioned the lack of guidance on rent levels for enhanced vouchers for opt-outs. Two commenters also wanted vouchers to be enhanced whenever an owner is rejected for renewal and where an owner opts out.

*HUD response:* The final rule reflects the provisions of section 538 of Public Law 106-74 on this point.

4. *Timing of tenant-based assistance.*

*Comment:* 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 four months. Another commenter wanted HUD to provide a short-term renewal 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.

**IV. Changes Made to Part 401**

References are to the section number of the rule.

*Section 401.2 What special definitions apply to this part?*

There have been no substantive changes from the March 22, 2000, final rule § 401.2. However, this final rule reorganizes the definition of "eligible project," moving it from § 401.2 to a new § 401.100(a), and replacing the § 401.2 definitions with a cross-reference.

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

Paragraph (a) of this section states the projects that are eligible for a restructuring plan. The list of eligible projects includes certain projects that receive project-based assistance and were renewed under section 524 of MAHRA.

Paragraph (b) of this section, entitled "When is eligibility determined?," addresses additional related statutory interpretation questions that arose after the public comment period closed for the proposed rule. While the Department considers it of benefit to the public to have these related interpretation questions addressed in published regulations, there is no requirement for additional public comment. Paragraph (b) constitutes an interpretative rule not subject to notice and comment rulemaking requirements.

This paragraph states that statutory eligibility for a Restructuring Plan under MAHRA is determined by the status of a project on the earlier of the expiration or termination date of the project-based assistance contract, which includes a contract renewed under section 524(a) of MAHRA, or the date of the owner's request for a Restructuring Plan. In order to determine whether project rents exceed comparable market rents for eligibility purposes, rent levels under a contract renewed under section 524(a) of MAHRA will be considered.

As a practical matter, no Restructuring Plan will be developed after prepayment, since debt restructuring is a required element of each Restructuring Plan. After an owner has submitted a request for debt restructuring, an owner's voluntary decision to prepay, however, will not convert the project to one entitled to exception rents. The situation is similar to any other decision of an owner of an eligible project to forgo the opportunity for a Restructuring Plan. HUD or a PAE

will review the contract renewal request under the procedure in § 402.4(a)(2) of the final rule to ensure that comparable market rents will be sufficient for project operations before project-based assistance is renewed.

*Section 401.600 Will a Section 8 contract be renewed if it would expire while an owner's request for a Restructuring Plan is pending?*

This regulatory section has been revised to make a nonsubstantive procedural revision that will make it less time-consuming for an owner to request an extension of Section 8 contracts at current rents, or, if such an extension has been granted, a further extension in cases where, through no fault of the owner, the restructuring plan has not been implemented within the regulatory deadlines. HUD has the statutory authority under section 514 of MAHRA (42 U.S.C. 1437f note) to extend a Section 8 contract for any period sufficient to implement the Restructuring Plan. However, under the current regulation, the only procedural means to do so is on an ad hoc basis. HUD's experience shows that a large number of projects seeking restructuring require extensions at current rents pending the implementation of a Restructuring Plan. To date, such extensions have been granted through a regulatory waiver process, which is relatively cumbersome. To address these issues, the rule is being amended to simplify the process and make it broadly available by allowing HUD to approve such extensions without a regulatory waiver. Since this change is a matter of internal agency procedure, public notice and comment is not required under the Administrative Procedure Act (5 U.S.C. 553(b)) and HUD's regulations on rulemaking at 24 CFR 10.1. The only other change is a nonsubstantive, editorial clarification in § 401.600(b).

**V. Changes Made to Part 402 of Interim Rule**

References are to the section number of the rule.

*Section 402.1 What is the purpose of part 402?*

The final sentence that appeared in § 402.1 of the interim rule regarding "bad owners," was moved to § 402.7 to more clearly reflect new section 524(b) of MAHRA. Some other changes to this section as it appeared in the interim rule have already been made in connection with final part 401. However, as a statement of policy, separate public notice on this final minor amendment is not required.

*Section 402.2 Definitions*

Language is added to this regulatory section to specify which definitions in MAHRA and part 401 apply to part 402. The rule adds definitions of "SRO contract" and "SRO project" (referring to single-room occupancy under section 441 of the Stewart B. McKinney Homeless Assistance Act), a definition for the purposes of this rule of "project eligible for exception rents" (referring to section 524(b) of MAHRA), and a definition of "portfolio reengineering demonstration authority" (referring to authority described in new section 524(e)(2)(B) of MAHRA). The rule also adds a definition of "large family" for use in connection with § 402.4(ii)(A), that follows HUD's existing definition used for "Consolidated Plans" (see 24 CFR 91.5) by defining a family of five or more persons as a large family.

Finally, the rule adds a definition of OCAF (operating cost adjustment factor) that incorporates a new statutory prohibition against negative OCAF. The term "OCAF" was used in interim part 402 in several places, generally without definition or explanation, although interim § 402.5(d) referred to "operating cost adjustment factor as provided in § 401.412." Section 401.412 is a provision of the Mark-to-Market rule that explains that OCAF is not applied to the debt service portion of rent. HUD has incorporated that explanation into the new part 402 definition to make it clearer that a single concept of OCAF is intended throughout parts 401 and 402.

Interim § 402.2 incorporated the Mark-to-Market program definition of "comparable market rents" from § 401.410(b). This final rule instead uses a revised definition to recognize that additional statutory language directly affecting part 402 (but not part 401) was added later to MAHRA by Public Law 106-74. Part 401 governs the question of whether a project is eligible for the Mark-to-Market program due to rents exceeding comparable market rents. For all other purposes under final part 402, determination of comparable market rent is now governed by new section 524(a)(5) of MAHRA added by Public Law 106-74 and referenced in § 402.2(c). In addition, the Assistant Secretary for Housing has provided relevant guidance on matters such as preparation and use of the rent comparability study (RCS) required from an owner for renewals of contracts not covered by section 524(b)(3) of MAHRA (most recently, in Chapter 9 of the Section 8 Renewal Policy Guidebook). Similarly, the Assistant Secretary for Public and Indian Housing uses administrative notices to state the

procedures that PHAs must use for determining comparability under section 524(b)(3) of MAHRA. HUD expects to continue this practice until any further rulemaking, if any, on this issue. Thus, the replacement definition of comparable market rents in this section simply references new section 524(a)(5) of MAHRA and HUD instructions in lieu of the prior incorporation of § 401.410(b).

*Section 402.3 Contract provisions*

The language regarding the contract term was moved from § 402.5(a) of the interim rule to § 402.3 of this final rule, and amended to recognize that HUD's discretion to set the contract term will be subject to any applicable statutory requirements concerning terms (e.g., new section 524(a)(3) of MAHRA requires at least 5-year terms when "marking up" rents, and the FY 2000 HUD Appropriations Act, Public Law 106-74, and subsequent HUD appropriations acts for FY 2001, Public Law 106-377, and FY 2002, Public Law 107-73, require one-year terms for FY 2000 preservation project renewals).

*Section 402.4 Contract renewals under section 524(a) of MAHRA*

Section 402.4 was included in a final rule published on March 22, 2000 (see 65 FR 15498). The preamble to that final rule explained that HUD would make additional changes to § 402.4(a)(2) after further consideration of the comments received on the interim rule (see 65 FR 15476). This final rule contains changes to § 402.4(a)(2) to clarify that the analysis regarding whether renewal of a HAP contract would be "sufficient"—that is, would maintain adequate debt service coverage and replacement reserve—is triggered upon the request of the owner, pursuant to recent statutory changes to section 524 of MAHRA. See § 402.4(a)(2)(i) of this final rule. This rule also reorganizes the section into a more logical format. Other changes to § 402.4 that require public comment are addressed in the accompanying proposed rule published in today's **Federal Register**.

*Section 402.5 Contract renewals under section 524(b) or (e) of MAHRA*

Language that linked budget-basing to the statutory procedure applicable to part 401, but not 402, was replaced by a general reference to HUD instructions to allow the greater flexibility for part 402 that Congress intended. A provision that permitted a rent comparability analysis as part of a budget-based adjustment was removed. This rule combines paragraphs (a) and (b), and simplifies former paragraph (d) on rent



adjustments (now paragraph (c)), by referencing proposed § 402.4(b), which is being published in today's **Federal Register**. Statutory references are revised in this section to reflect the revised description in the statute for projects entitled to exception rents, and clarify that renewal requests from owners of moderate rehabilitation projects eligible for exception rents will always be governed by § 402.5(c)(ii).

New paragraph (d) corresponds to new section 524(e) of MAHRA on preservation and demonstration projects. That section authorizes certain renewals, notwithstanding other statutory restrictions, in order to provide benefits comparable to those in preservation plans of action or contracts previously renewed under demonstration authority. Paragraph (d) applies only to the extent amounts are "specifically" made available in appropriations acts for preservation projects. The appropriations acts for FY 2000–2002 made amounts available, but for preservation projects the language of each of these appropriations limited renewals to one year. (See Pub. L. 106–74, 106–377, and 107–73).

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

A renewal contract issued under section 524 of MAHRA is not expressly cited among the list of assistance contracts identified under section 512(2)(B) of MAHRA for a project to be eligible for debt-restructuring. However, upon consideration of the issue of whether a contract already renewed under section 524 may be eligible for debt restructuring, HUD has determined that, as a matter of law, a section 524 renewal contract retains the essential Section 8 character of the underlying Section 8 contract and is thus to be treated as eligible for debt-restructuring. (Sections 512(2)(A) and 512(2)(C), however, impose additional requirements for a project to be eligible for debt-restructuring.) HUD bases this interpretation on language in the last sentence of section 512(2)(C) that explicitly reflects a dual source of authority, Section 8 of the United States Housing Act of 1937 and section 524 of MAHRA, for a section 524 renewal contract. The other bases for this determination are MAHRA's definition of "renewal," section 512(12), "the replacement of an expiring Federal rental contract with a new contract under Section 8 of the United States Housing Act of 1937," and the identification in section 524(a)(1) of amounts available "under Section 8" as the funding for renewal assistance

under section 524. In accordance with this position, HUD is removing: (1) References to the statutory term "expiring contract," the definition of which uses another statutory term; "project-based assistance," that refers to the list of assistance contracts in section 512(2)(B); (2) the term "initial," as opposed to other renewals, throughout this rule; and (3) "project-based assistance" from the list of statutory definitions that the rule is adopting in § 402.2(b).

The introductory language in this regulatory section that applied paragraph (a) only to contracts with expiration dates after October 1, 1998, was considered unnecessary and removed. Paragraph (a) of this section was simplified by removing the specific listing of information required from an owner requesting contract renewal. The specific listing was never intended as an exclusive listing. In the final rule of March 22, 2000, HUD published a revised paragraph (a)(3) of this section, requiring the most recent audited financial statement and evaluation of physical condition of the property (see 65 FR 15498). This section, in accordance with regulatory simplification, has been removed in this final rule. Since this change is one of agency procedure, additional public comment is not required under the Administrative Procedure Act and HUD's rulemaking regulations at 24 CFR 10.1. The following clarifies certain points about the specific mandatory information items that were previously in the interim rule, but are omitted from the final rule:

- A financial statement and owner's evaluation of physical condition (OEPC) are not required for a project that is not eligible for restructuring. When an OEPC is required, a recent comprehensive needs assessment may be used in lieu of an OEPC to conform to the final § 401.450.

- A rent comparability study must meet HUD's requirements. HUD may require a less detailed analysis when project rents are below a certain threshold level or when nearly identical units, located in the Section 8 project and not receiving tenant rental assistance, are used to set the market rent ceiling.

- The rule now provides that once a project has been renewed under section 524 of MAHRA, it will be renewed at the owner's request under any renewal option for which the project is eligible, except that if it is eligible for a Restructuring Plan under § 401.100, HUD or a PAE will determine whether a renewal with or without a Restructuring Plan is necessary.

- The owner is no longer required to certify that no affiliate is suspended or debarred. This change corresponds to a change previously made in the final version of part 401 and recognizes that renewal decisions when an owner's affiliate is debarred or suspended may require case-by-case review. However, the requirement for a civil rights certification pursuant to 24 CFR 5.105(a) continues to apply to all affiliates, subcontractors, and associates of the owner.

Paragraph 402.6(b) was updated to reflect HUD's interpretation of MAHRA that a contract that was initially renewed under the renewal provisions of MAHRA is eligible for renewal at the owner's request under any renewal option for which the project is eligible. However, in the case of a project that is eligible for a Restructuring Plan under § 401.100, HUD or a PAE will determine whether renewal with a Restructuring Plan under part 401, or without a Restructuring Plan under this part, is necessary.

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

The 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, was determined obsolete and removed. Paragraph (c) concerning the availability of tenant-based assistance after certain rejections of requests for renewal of project-based assistance was also removed because the subject is covered in a broader new § 402.8(c) in the final rule. Language in § 402.1 was moved as explained in the discussion of that section.

Section 524(a)(2) of MAHRA, as amended by section 531(a) of Public Law 106–74, states that determinations of ineligibility under section 516(a) of MAHRA are to be made by the Secretary only, without the participation of the PAE. Prior law included the PAE in that decision. Section 402.7 of the rule reflects this statutory change.

*Section 402.8 Tenant protection if a contract is not renewed*

This rule updates this section to reflect HUD policy and statutory changes to section 8(c)(8) of the United States Housing Act of 1937 (42 U.S.C. 1437f(c)(8)) (1937 Act). The rule adds language in paragraph (a) specifying that required notice to HUD should be sent to HUD and the contract administrator, if there is one, and to the tenants. A new paragraph (c) recognizes that HUD must, to the extent Congress provides

appropriations in advance for this purpose, provide tenant-based assistance whenever project-based assistance is not renewed. This will permit HUD to continue current policies. In paragraph (b), language is added to clarify the continued applicability of the owner's obligation to permit tenants to remain in assisted units with no increase in the tenant rent (i.e., rent no higher than the last month's assisted tenant rent under the terminated HAP contract) until one year after the owner gives the termination notice, even if HUD does not continue to provide housing assistance payments for such units during the notice period. This is consistent with section 8(c)(8)(B) of the 1937 Act, as amended by section 535 of Public Law 106-74 (42 U.S.C. 1437f(c)(8)(B)). Ordinarily, HUD will continue to make section 8 assistance available for units during the one-year period. Section 8(c)(8)(A) of the 1937 Act now requires the owner's termination notice to state, among other things, that HUD "will" provide tenant-based assistance (vouchers) to all eligible residents of the project to enable them to choose the place they wish to rent, which is "likely" to include their current dwelling unit. Congress has thereby recognized that the continued availability of section 8 assistance for specific units after termination notice may be inappropriate. For example, a voucher HAP contract cannot be executed for a unit that has been determined to violate the Housing Quality Standards (HQS) for the voucher program. Tenants of such substandard units may use vouchers under the Housing Choice Voucher program to move to other units in better condition, but any tenants who choose to remain in substandard units without assistance during the remainder of the one-year termination notice period are still protected from rent increases by section 8(c)(8)(B) of the 1937 Act, which does not condition this protection on the continued availability of assistance under section 8 for the unit.

Finally, the final rule removes the sentence in § 402.8(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. (Under the rule as written, the period begins on the date of actual notice to the tenants.) This change conforms to a change previously made to § 401.602 of the Mark-to-Market final rule. 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.

## VI. Findings and Certifications

### *Paperwork Reduction Act*

The information collection requirements contained in this final rule are currently approved by the Office of Management and Budget (OMB) under section 3504(h) of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0533. 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 currently valid control number.

### *Environmental Impact*

On September 6, 2000, a finding of no significant impact with respect to the environment was made regarding this rule 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. 4332). That finding of no significant impact remains applicable, and is available for public inspection between 8:00 a.m. and 5 p.m. weekdays in the office of the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500.

### *Executive Order 12866*

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. 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 8 a.m. and 5 p.m. weekdays in the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500.

### *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.

This rule affects only multifamily section 8 owners. There are very few multifamily section 8 owners that are small businesses. Therefore, this rule will not affect a substantial number of small entities.

### *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 (Pub. L. 104-4, approved March 22, 1995) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and the private sector. This rule does not impose any federal mandates on any state, local, or tribal government, 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.

The Catalogue of Federal Domestic Assistance number for the programs affected by this rule is 14.871.

■ For the reasons set forth in the preamble, HUD amends 24 CFR parts 401 and 402 as follows:

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

■ 1. The authority citation is revised to read as follows:

**Authority:** 12 U.S.C. 1715z-1 and 1735f-19(b); 42 U.S.C. 1437(c)(8), 1437f(t), 1437f note, and 3535(d).

■ 2. Section 401.2(c) is amended by revising the definition of "eligible project" to read as follows:

### **§ 401.2 What special definitions apply to this part?**

\* \* \* \* \*

*Eligible project* means a project that meets the requirements for eligibility for a Restructuring Plan in § 401.100.

\* \* \* \* \*

■ 3. Add a new § 401.100 to read as follows:

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

(a) *What are the requirements for eligibility?* To be eligible for a Restructuring Plan under this part, a project must:

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

(2) Be covered in whole or in part by a contract for project-based assistance under—

(i) The new construction or substantial rehabilitation program under section 8(b)(2) of the U.S. Housing Act of 1937 as in effect before October 1, 1983;

(ii) The property disposition program under section 8(b) of the U.S. Housing Act of 1937;

(iii) The moderate rehabilitation program under section 8(e)(2) of the United States Housing Act of 1937;

(iv) The loan management assistance program under section 8 of the United States Housing Act of 1937;

(v) Section 23 of the United States Housing Act of 1937 as in effect before January 1, 1975;

(vi) The rent supplement program under section 101 of the Housing and Urban Development Act of 1965;

(vii) Section 8 of the United States Housing Act of 1937, following conversion from assistance under Section 101 of the Housing and Urban Development Act of 1965; or

(viii) Section 8 of the U.S. Housing Act of 1937 as renewed under section 524 of MAHRA;

(3) Have 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) Have a first mortgage that has not previously been restructured under this part or under HUD's Portfolio Reengineering demonstration authority as defined in § 402.2(c) of this chapter;

(5) Not be a project that is described in section 514(h) of MAHRA; and

(6) Otherwise meet the definition of "eligible multifamily housing project" in section 512(2) of MAHRA or meet the following three criteria:

(i) The project is assisted pursuant to a contract for Section 8 assistance renewed under section 524 of MAHRA;

(ii) It has an owner that consents for the project to be treated as eligible; and

(iii) At the time of its initial renewal under section 524, it met the

requirements of section 512(2)(A), (B), and (C) of MAHRA.

(b) *When is eligibility determined?* Eligibility for a Restructuring Plan under paragraph (a) of this section is determined by the status of a project on the earlier of the termination or expiration date of the project-based assistance contract, which includes a contract renewed under section 524 of MAHRA, or the date of the owner's request to HUD for a Restructuring Plan. Eligibility is not affected by a subsequent change in status, such as contract extension under § 401.600 or part 402 of this chapter.

■ 4. Revise 24 CFR 401.600 to read as follows:

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

(a) 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:

(1) For up to the earlier of one year or closing on the Restructuring Plan under § 401.407; or

(2) For such period of time beyond one year as HUD may approve, up to the closing of the Restructuring Plan.

(b) Any extension of the contract beyond one year for a pending Restructuring Plan, other than an extension approved under this section, must be at comparable market rents or exception rents. An extension at comparable market rents will not affect a project's eligibility for the Mark-to-Market program once it has been established under this part.

(c) HUD may terminate the contract earlier if the PAE or HUD determines that an owner is not cooperative under § 401.402 or if the owner's request is rejected under § 401.403 or § 401.405.

**PART 402—SECTION 8 PROJECT-BASED CONTRACT RENEWAL UNDER SECTION 524 OF MAHRA**

■ 5. The heading to part 402 is revised to read as set forth above.

■ 6–7. The authority citation for part 402 is revised to read as follows:

**Authority:** 42 U.S.C. 1437(c)(8), 1437f note, and 3535(d).

■ 8. Revise § 402.1 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 assistance contracts under the authority provided in section 524 of MAHRA.

■ 9. Revise § 402.2 to read as follows:

**§ 402.2 Definitions.**

(a) *Terms defined in part 401.* In this part, the following terms have the meanings given in § 401.2 of this chapter: affiliate, disabled family, elderly family, eligible project, HUD, MAHRA, owner, PAE, Restructuring Plan, and section 8.

(b) *Terms defined in MAHRA.* In this part, the following terms have the meanings given in section 512 of MAHRA: expiration date, fair market rent, renewal, and tenant-based assistance.

(c) *Other defined terms.* In this part, the term—

*Comparable market rents* means rents determined in accordance with section 524(a)(5) of MAHRA and HUD's instructions.

*Large family* means a family of five or more persons.

*OCAF* means an operating cost adjustment factor established by HUD, which may not be negative, that is applied to the existing contract rent (less the portion of that rent paid for debt service).

*Portfolio Reengineering demonstration authority* means the authority specified in section 524(e)(2)(B) of MAHRA.

*Project-based assistance* means the types of assistance listed in section 512(2)(B) of MAHRA, or a project-based assistance contract under the Section 8 program renewed under section 524 of MAHRA.

*Project eligible for exception rents* means a project described in section 524(b) of MAHRA.

*SRO contract and SRO project* mean, respectively, a project-based assistance contract for single-room occupancy dwellings under section 441 of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11401), and a project with units covered by such a contract.

■ 10. Revise § 402.3 to read as follows:

**§ 402.3 Contract provisions.**

The renewal HAP contract shall be construed and administered in accordance with all statutory requirements, and with all HUD regulations and other requirements, including changes in HUD regulations and other requirements during the term of the renewal HAP contract, unless the contract provides otherwise.

■ 11. Amend § 402.4 by revising paragraph (a)(2) to read as follows:

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

(a) \* \* \*

(2) *Procedure for projects eligible for Restructuring Plan.* (i) If an owner

requests renewal of a contract under this section for a project that is eligible for a Restructuring Plan under the Mark-to-Market program under part 401 and that has not been rejected under that part, HUD or a PAE will determine whether renewal under this section, instead of through a Restructuring Plan under part 401 of this chapter, would be sufficient. Renewal without a Restructuring Plan will be considered sufficient if the rents after renewal 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.

(ii) If HUD or the PAE determines that renewal under this section would be sufficient, HUD will not require a Restructuring Plan.

(iii) If HUD or the PAE determines that renewal under this section would not be sufficient, HUD or the PAE may require a Restructuring Plan before the owner's request for contract renewal will be given further consideration. If the owner does not cooperate in the development of an acceptable Restructuring Plan, HUD will pursue whatever administrative actions it considers necessary.

\* \* \* \* \*

■ 12. Revise § 402.5 to read as follows:

**§ 402.5 Contract renewals under section 524(b) or (e) of MAHRA.**

(a) *Renewal of projects eligible for exception rents at owner's request.* HUD will offer to renew project-based assistance for a project eligible for exception rents under section 524(b) of MAHRA at rent levels determined under this section instead of § 402.4, except as provided in § 402.7, but the owner of a project other than a project with assistance under the Section 8 moderate rehabilitation program may request renewal under § 402.4.

(b) *Rent levels for projects eligible for exception rents.* HUD will renew the contract with rent levels at the least of:

(1) Existing rents adjusted by an OCAF;

(2) A budget-based rent determined in accordance with instructions issued by HUD, subject to a determination by HUD that such a rent level is appropriate; or

(3) In the case of a contract under the Section 8 moderate rehabilitation program (other than an SRO contract), the lesser of existing rents adjusted by an OCAF, fair market rents (less any amounts for tenant-purchased utilities),

or comparable market rents, as provided in section 524(b)(3) of MAHRA.

(c) *Rent adjustments.* (1) After rents have been established under this section, rent adjustments will comply with section 524(c) of MAHRA except as otherwise required by paragraph (d)(1) of this section for preservation projects.

(2) Rent adjustments for projects assisted under the Section 8 moderate rehabilitation program, other than projects assisted under the moderate rehabilitation single-room occupancy program, shall be determined in accordance with section 524(b)(3) of MAHRA.

(d) *Preservation projects and demonstration projects.* (1) Notwithstanding any other provision of this part except § 402.7, upon expiration of a section 8 contract for a project subject to an approved plan of action under the Emergency Low-Income Housing Preservation Act of 1987 (ELIHPA) or the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (LIHPRHA), the Secretary will provide benefits that are comparable to those provided under such plan of action. This paragraph (d)(1) applies only to the extent amounts are specifically made available in appropriations acts.

(2) Notwithstanding any other provision of this part except § 402.7, upon expiration of a Section 8 contract entered into pursuant to a Portfolio Reengineering demonstration authority for which HUD made a determination that debt restructuring is inappropriate, and the owner of the project executed a Portfolio Reengineering Demonstration Program Use Agreement, the Secretary will provide the owner, at the request of the owner, with benefits comparable to those provided under the contract that is expiring. This paragraph (d)(2) applies only to the extent amounts are made available in appropriations acts.

■ 13. Revise § 402.6 to read as follows:

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

(a) *In general.* An owner requesting contract renewal under this part must submit to HUD or HUD's designee, at least 120 days before the termination or expiration date of any project-based assistance contract, all documents or information prescribed by HUD.

(b) *Subsequent renewals.* A contract that was initially renewed under MAHRA will be renewed at the owner's request under any renewal option for which the project is eligible. However, in the case of a project that is eligible for a Restructuring Plan under § 401.100, HUD or a PAE will determine

whether renewal with a Restructuring Plan under part 401, or without a Restructuring Plan under this part, is necessary.

■ 14. Revise § 402.7 to read as follows:

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

(a) *Determination of eligibility.* Notwithstanding part 24 of this title, HUD may elect not to consider a request for renewal of project-based assistance if at any time before contract renewal:

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

(2) HUD determines that the owner or an affiliate has engaged in material adverse financial or managerial actions or omissions as described in section 516 of MAHRA, including any outstanding violations of civil rights laws, or has failed to certify to compliance with the nondiscrimination requirements of 24 CFR 5.105(a), in connection with any project of the owner or an affiliate; or

(3) The project does not meet the physical condition standards in 24 CFR 5.703 of this title, unless HUD determines that the project will meet the standards within a reasonable time after renewal.

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

■ 15. Revise § 402.8 to read as follows:

**§ 402.8 Tenant protections if a contract is not renewed.**

(a) *Notice of termination.* An owner who is not eligible for a Restructuring Plan under part 401 of this chapter, or who is eligible but does not request restructuring, and who does not renew a contract, must provide one year's notice to tenants, to HUD, and to the contract administrator as provided in section 8(c)(8)(A) of the United States Housing Act of 1937.

(b) *If an owner does not give timely notice.* If an owner does not give one year's notice of termination as described in paragraph (a) of this section, the owner must permit the tenants in assisted units to remain in their units at a rental rate no higher than the tenant rent payable for the tenants' last month of assisted occupancy under the terminated HAP contract until one year after notice is given, even if HUD does not continue to make housing assistance payments with respect to such units.

(c) *If an owner opts out or fails to renew.* In the case where a contract for Section 8 rental assistance for a project

is terminated or expires, an assisted family may elect to remain in the project and, if eligible, receive tenant-based Section 8 assistance under Section 8(t) of the United States Housing Act of 1937.

■ 16. Add 24 CFR 402.9 to read as follows:

**§ 402.9 Waivers and delegations of waiver authority.**

All waivers of provisions of this part, and delegations of the authority to waive provisions of this part, are governed by § 5.110 of this title.

Dated: December 16, 2005.

**Brian D. Montgomery,**

*Assistant Secretary for Housing-Federal Housing Commissioner.*

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