HOME PROGRAM

CONSIDERATIONS FOR CONVERSION FROM HOMEBUYER TO RENTAL

BACKGROUND

Because of current housing market conditions, many HOME Participating Jurisdictions are confronted with unsold homes originally constructed or rehabilitated for sale to income eligible buyers. In some cases, projects will be converted to rental, triggering substantially different requirements than those anticipated at project inception. This list has been prepared to highlight key regulatory, policy, and procedural implications that PJs need to consider and account for in restructuring both their written agreements and, to some degree, their internal policies and procedures. It is not intended to cover every possible scenario or be a comprehensive checklist of every itemized compliance issue.

OCCUPANCY & RENTS

- HOME income limits must be applied to the project
  - Program Rule – PJs should assess implications of meeting the Program Rule (90% at 60%), which may practically require initial tenants to have incomes below 60% AMI (Program Rule).
  - Project Rule – If a scattered site project of 5 or more rental units under common ownership, financing and management, the Project Rule (at least 20% at 50% AMI) must be met for the affordability period (Project Rule).

- Use appropriate definition of income
  - Most PJs use the Part 5 (i.e. Section 8) definition of income for rental, but they may have adopted a different standard, such as the IRS 1040 definition, for homebuyer programs. So converting to rental will involve using the correct income definition per your local program design.

- HOME Rent Limits, including Utility Allowances, apply
  - PJs that have not previously done rental may need to establish a utility allowance schedule or may want to adopt one established by the local PHA's Housing Choice Voucher Program.
  - PJs should remember that rent limits may not change year-to-year, while operating costs will, so setting initial rents below the limit may help ensure viability.

- Lease terms, both required and prohibited
  - PJ should review the proposed form lease to ensure it includes the required tenant protections and excludes any of the prohibited lease terms in 92.253, including the 30 day notice provisions.

- Fair Housing and Affirmative Marketing
  - Projects with 5 or more HOME assisted units must meet the Affirmative Marketing requirements of 92.351, but the target audience and affirmative marketing activities may change as a result of converting to a rental project.
  - For rental projects, affirmative marketing becomes an ongoing expectation in a way that does not apply to homebuyer projects.

OPERATIONS

- Operating budget — Have you assessed the operating budget and determined the need for reserves? Is there a source to fund those reserves?
  - Considerations should include the project's ability to afford debt service, whether there is other debt service on the property, whether net operating income is being deposited to capital reserves for future rehabilitation needs, and the like. Repayment terms may need to be structured to avoid forcing the project into a predictable default or conversely to ensure that cash flow is not excessive under the PJ's subsidy layering guidelines (as applicable).

- Property Standards, including LBP requirements as applicable
  - Ongoing compliance with local housing codes, if applicable, or HQS.
  - LBP ongoing maintenance (if applicable) – When the property was built prior to 1978, the LBP requirements of 24 CFR Part 35 continue to apply, and in the case of rental properties there are ongoing inspection and maintenance requirements specific to identified LBP hazards that apply to the property owner and manager. These requirements would not have been anticipated in a written agreement for a homebuyer project.

- Occupancy requirements
  - Income limits must be distributed annually.
  - Rent limits and utility allowance schedule must be distributed annually.
  - Tenant income certifications must be done annually in compliance with 92.203.
  - Tenant files must be maintained, with the most recent 5 years of files available for inspection.

- Ongoing compliance
  - Annual compliance reports are required.
  - PJ must go onsite to review files and inspect properties every 1 – 3 years, per the schedule in 92.504.

- Tenant selection and management plan
  - Tenant selection plan should ensure compliance with all Fair Housing requirements.
  - Management plan should identify how property will be managed and maintained.
  - If a CHDO project, must have tenant participation plan.

- Asset management — It is highly recommended that annual reviews include operating budget projections and comparisons to actual performance, assessment of operating and/or replacement reserves (including periodic re-setting of required reserve deposits), and prohibitions on "cash flow" distributions without PJ approval.

FINANCING TERMS/WRITTEN AGREEMENT/LEGAL DOCUMENTS

- HOME financing — With the change to rental, the financing for the project will need to be restructured. Several issues might arise:
  - The HOME financing likely will need to be turned into a permanent loan to the project for the affordability period.
  - The amount of HOME assistance to the project might need to be increased, depending upon the interim financing and the project's ability to carry debt.

- Written agreement – The Agreement will need to be updated to reflect a conversion to rental, and address the regulatory requirements of 92.252, 92.253 and 92.251.
  - If a CHDO project, CHDO Proceeds may need to be addressed. Proceeds are now unlikely to be generated by rental operations, but this may become applicable if a 92.255 sale to the tenant occurs during the affordability period.
  - Record retention requirements change; they apply to occupancy records for the affordability period.

- Deed covenant – Ensure that there is a covenant running with the land or other acceptable regulatory agreement.
  - For projects initially planned as homebuyer units, the PJ may not have placed a covenant running with the land, and even if it had, the provisions would not have addressed HOME Rental requirements. In converting, PJs should also review what other liens or restrictions of record are senior to the HOME covenant and where possible seek subordinations from other parties with beneficial interests of record.
  - Note and Mortgage (deed of trust) — In addition to the covenant running with the land and a written agreement, it is recommended that the PJ secure its HOME investment with a Note and Mortgage. Most PJs require some form of Note and Mortgage for homebuyer projects as well, but typically those are structured to require repayment in a lump sum upon sale to an eligible buyer or in the event of a default. The PJ should consider how to structure a HOME loan in the case of rental conversion and structure appropriate lending documents.

- IDIS setup & project determination
  - The IDIS setup needs to be altered to reflect the rental project(s) that will be created. Remember that a "project" is characterized by common ownership, common management, and a common plan of finance, so a PJ's decisions about whether and how to group multiple units into a single scattered site project will affect various regulatory issues such as income and rent restrictions.
  - Within this context, if there will be a multi-unit project involving a mix of HOME and other funding where the PJ wants to designate some units as "unassisted," a careful cost allocation determination will be needed to establish the minimum number of HOME assisted units that are required.

- Period of Affordability
  - If the unit to be rental was newly constructed, the Affordability Period must be 20 years. In other cases (acquisition and rehabilitation), the affordability period must be based on the total per-unit HOME assistance (rather than just buyer assistance) from the revised cost allocation analysis.