

OMB Approval No. 2502-0086

Special Attention of:
Multifamily Hub Directors
Multifamily Program Center
Directors
Project Managers
Secretary's Representatives
Senior Community Builders
Section 236 Owners, Management Agents
Contract Administrators and Housing
Finance Agencies

NOTICE: H 01-07 (HUD)

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Cross References:

**Subject: GUIDELINES FOR CALCULATING AND RETAINING SECTION 236
EXCESS INCOME**

APPLICABILITY: This Notice applies to all Section 236 projects with assistance through the Section 236 Interest Reduction Payments Program.

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I. PURPOSE

This Notice supersedes Notice H 00-17 and provides guidelines for implementation of Section 216 of the Department's Fiscal Year 2001 Appropriations Act, P.L. 106377 and Section 861 of the American Homeownership and Economic Opportunity Act of 2000, P.L. 106-569. Section 861 of the American Homeownership and Economic Opportunity Act of 2000 amends Section 236(g) of the National Housing Act, and provides an extension of the authority to retain Excess Income. It also provides, in relevant part, that any Excess Income that a project owner has collected and that such owner has not remitted to the Secretary of HUD may be retained by such owner unless the Secretary otherwise provides. Instructions are provided for an owner's participating in retention of Excess Income for projects with assistance through the Section 236 Interest Reduction Payments Program.

There is presently a Regulation at 24 CFR 236.60 (Rev. April 1, 1995) which has been saved by 24 CFR 236.1(c) of the current CFR. Such Regulation, in general, provides that Excess Income is to be remitted to HUD. HUD is in the process of updating the Regulations to reflect Sections 216, 861 and other statutory changes made after 1995.

One of the objectives of this Notice and the ones heretofore issued permitting owners to retain Excess Income has been for the Department to obtain practical case by case experience in connection with recently expanded statutory authority in this area. The Department's intention is to utilize experience gained through this and previous Notices to promulgate a new regulation. The Assistant Secretary has issued a waiver of the current regulation to cover these Notices pending promulgation of this replacement regulation.

NOTE: Any Excess Income that a project owner may retain that has been generated since October 1, 2000 and that the owner has not remitted to the Secretary may be retained by the owner provided the owner is in compliance with the requirements of this Notice.

II. POLICY

- A. All Section 236 projects, where the owner is current with respect to the mortgage obligation, are eligible for consideration to retain Excess Income generated on or after October 1, 2000 for project and non-project use.

- B. Prior HUD approval is needed.
- C. HUD will not withhold approval of an owner's request to retain Excess Income because of the existence of unpaid Excess Income charges, if such income is being repaid over a period of time in accordance with a Workout or Repayment Agreement with the Secretary unless the owner is in violation of such Agreement.
- D. All owners must immediately remit to HUD all Excess Income unless they were approved for retention of Excess Income under Notice H 00-17 or an approved Preservation Plan of Action (POA) or Notices H 9810 or H 99-28.
- E. If an owner fails to remit to HUD all Excess Income that was not approved under Notice H 00-17 or a POA or predecessor Notice, the Excess Income will then be considered unpaid.

III. RETAINING SECTION 236 EXCESS INCOME

- A. Definition: Excess Income consists of cash collected as rent from the residents by the owner, on a unit-by-unit basis, that is in excess of either the HUD-approved unassisted Basic Rent or the New Authorized Rent under the Section 8 mark-up-to-market program. The unit-by-unit requirement necessitates that, if a unit has Excess Income, it must be returned to HUD. It is not permissible to do an aggregate calculation of the Excess Income for all occupied rent-paying units, and then to offset or subtract from that figure any unpaid rent from occupied or vacant units, before remitting Excess Income to HUD. Offsets are statutorily not permitted.

NOTE: There is no Excess Income associated with units where Section 8 is available or utilized.

- B. Who May Participate and Retain Excess Income.
 - 1. For Project Use: Effective October 1, 2000 all owners of projects receiving Section 236 Interest Reduction Payments are eligible for consideration to retain Excess Income for project use under the terms of this Notice unless the owner owes HUD Excess Income from prior periods. In such a case, the owner is no longer eligible for retention of Excess Income unless it has a Workout or Repayment Agreement acceptable to HUD and is current in payments under such Agreement. All past due unpaid Excess Income must be paid in full to HUD

before future Excess Income may be retained, with the exception of those owners who are remitting Excess Income over a period of time in accordance with, and current in, payments under a Workout Agreement with the Secretary.

2. For Non-Project Use: Effective October 1, 2000 all owners of projects receiving Section 236 Interest Reduction Payments are eligible for consideration to retain Excess Income for non-project use unless they owe prior Excess Income and are not current in payments under a HUD-approved Workout or Repayment Agreement or they fall within any of the categories below:
 - a. The Reserve for Replacement is not fully funded.
 - b. The project under the statute is not "well maintained housing in good condition" which the Department interprets to mean the owner has failed to maintain the property in decent, safe, and sanitary condition and in good repair in accordance with HUD's Uniform Physical Conditions Standards described in 24 CFR Part 5, Subpart G and the State/local Code. A score of 60 or above on the Real Estate Assessment Center (REAC) physical inspection can support a finding that the property is in the required "good" condition. A Comprehensive Needs Assessment that finds there are no significant current repair or maintenance needs can also support a finding that the property is in the required "good" condition.
 - c. The owners have engaged in any one of the material adverse financial or managerial actions or omissions listed below:
 - 1) materially violated any Federal, State, or local law or regulation with regard to their project or any other federally assisted project, after receipt of notice and an opportunity to cure;
 - 2) materially breached a contract for assistance under Section 8 of the United States Housing Act of 1937, after receipt of notice and an opportunity to cure;
 - 3) materially violated any applicable regulatory or other agreement with the Secretary or a participating administrative entity, after receipt of notice and an opportunity to cure;

- 4) repeatedly and materially violated any Federal, State, or local law or regulation with regard to the project or any other federally assisted project';
- 5) repeatedly and materially breached a contract for assistance under Section 8 of the United States Housing Act of 1937;
- 6) repeatedly and materially violated any applicable regulatory or other agreement with the Secretary or a participating administrative entity;
- 7) repeatedly failed to make mortgage payments at times when project income was sufficient to maintain and operate the property;
- 8) materially failed to maintain the property in decent, safe and sanitary condition and good repair after receipt of notice and a reasonable opportunity to cure; and
- 9) committed any actions or omissions that would warrant suspension or debarment by the Secretary.

IV. USAGE OF EXCESS INCOME

For Project Use: Excess Income may be used for any project purpose. Examples are:

1. Project operating shortfalls, including repair costs;
2. Repair costs identified such as in the Comprehensive Needs Assessment, including increasing deposits to the Reserve Fund for Replacements to a limit necessary to adequately fund the reserve,
3. Service Coordinators;
4. Neighborhood networks located at the project for project residents; and
5. Enhanced supportive services for the residents.

NOTE: Nonprofit entities are not permitted to derive profit or gain from the project. Therefore, Excess Income retained for non-project use is limited to those activities that carry out an entity's nonprofit purpose.

V. **REQUESTING HUD'S APPROVAL TO RETAIN EXCESS INCOME**

A. For project use:

1. Submit a written request to the local Field Office; and
2. Briefly describe the proposed use of Excess Income, the period for which the Excess Income is being retained and amount or percentage of Excess Income requested.

B. For non-project use:

Submit a written request to the local Field Office.

- C. When the Field Office approves the request to retain Excess Income, prepare and mail a revised Form HUD-93104, Monthly Report of Excess Income, to Excess Rental Income, P.O. Box 360333M, Pittsburgh, PA, 15250 and send a copy to the Field Office.

NOTE: Owners in the above category, who have not submitted updated reports to the above address and a copy to the Field Office must do so promptly.

- D. Owners who wish to retain Excess Income generated in Fiscal Year 2001 should immediately submit a request to the local Field Office. For each subsequent fiscal year, owners must submit a request at least 90 days prior to the beginning of each fiscal year, or 90 days prior to any other time during a fiscal year that they wish to begin retaining Excess Income for that fiscal year.
- E. Owners who may have been holding their Excess Income generated on or after October 1, 2000, while awaiting further instructions from HUD must:
1. **Immediately** return all Excess Income prior to the date of this Notice's issuance **if, upon review of the provisions of this Notice, they will not be applying to retain Excess Income generated on or after October 1, 2000.**
 2. Immediately submit a written request to the HUD Field Office to retain any Fiscal Year 2001 Excess Income generated on or after October 1, 2000, if the owner is interested in retaining such Excess Income. The request must contain the same information as required in Sections V. A. or B. above. When the Field office approves the request to retain Excess Income, prepare and mail a revised Form HUD-93104, Monthly Report of

Excess Income to: Excess Rental Income, P.O. Box 360333M, Pittsburgh, PA 15250 with a copy to the Field Office.

- F. Owners who have been remitting Excess Income to HUD on a continual basis can submit a written request to the Field office for the retention of Excess Income generated after the date of this Notice's issuance. The request must contain the same information as required in Sections V. A. or B. above.

NOTE: When the owner proposes to use Excess Income in a manner different from what was approved, HUD's written approval is required.

- G. HUD Field Office response: HUD staff will review the owner's request and issue a letter of permission or denial.
1. The approval letter from HUD permitting the owner to retain Excess Income must, at a minimum, expressly assert:
 - a. Retention rights are for the time specified in the approval letter, but cannot extend beyond the current Fiscal Year;
 - b. Failure of the owner to maintain the Reserve for Replacement account, at all times, in a fully funded amount, is grounds for HUD to rescind the approval (See Section III.B.2.a);
 - c. Failure of the owner to maintain the property at all times in a condition that is "decent, safe and sanitary, and in good repair" is grounds for HUD to rescind the approval (See Section III.B.2.b);
 - d. If Excess Income is not used for the proposed purpose that the owner described in its application (See Section. V.A.2.), such income must be returned to HUD unless the owner has obtained prior HUD approval for an alternate use;
 - e. If the owner does not return the Excess Income that it received as a result of assurances provided (but not lived up to), the retention of that income is a violation of the Regulatory Agreement for which there are enforcement remedies since the Regulatory Agreement requires that Excess Income be remitted to the Commissioner.

2. **A denial letter** from HUD must cite the specific reasons for denial and state what would be required of the owner to receive HUD's permission to retain Excess Income.

NOTE: When the owner has corrected the conditions to HUD's satisfaction, the Field Office is authorized to advise the owner in writing to begin to retain Excess Income on a prospective basis for the period requested by the owner but for no longer than the remainder of the fiscal year.

- H. Update Real Estate Management System (REMS): Project managers in the Field Office should update the Excess Income Section in the Loan Information Detail Screen in REMS. For information on accessing and using the Loan Information Detail Screen refer to Chapter 5 of the REMS User Guide.

NOTE: This does not apply to non-insured State Agency projects whose mortgages are assisted under the Section 236 program.

I. HUD's Withdrawal of Approval to Retain Excess Income:

1. The retention of Excess Income by owners is a privilege, not a right, extended by the Department to responsible owners.
2. HUD may withdraw approval:
 - a. If at any time an owner fails to meet basic eligibility enumerated in Section III. B.;
 - b. For not using the Excess Income for purposes the owners had committed;
 - c. Where the owner has been approved for retention of Excess Income for non-project use, if at any time during the fiscal year-that -such approval is operative the owner fails to maintain the property in decent, safe and sanitary condition and in good repair, or if it fails to maintain full funding of the required reserves. A REAC physical inspection score of below 60 can support a finding that the housing is no longer in decent, safe and sanitary condition and in good repair.
3. Any Excess Income inappropriately used must be repaid to HUD and will be considered for enforcement purposes as a misuse of Government funds.

- a. The HUD Field Office will notify the owner via certified mail that the authorization to retain Excess Income is withdrawn. The letter must state:
 - 1) The effective termination date which should be the date HUD determined that the owner is not in compliance with HUD's requirements;
 - 2) Specific reasons for HUD's withdrawal of approval;
 - 3) What actions are needed to restore receiving Excess Income; and
 - 4) Request a return of such income to HUD in the amount that was not properly used.
- b. An owner may appeal HUD's decision by submitting a letter stating the basis for reconsideration. The letter should include documentation supporting a review of the denial and should be addressed to the Hub/Program Center Director.
- c. Upon receipt of the information, the Hub/Program Center Director will have 30 days to make a final determination and respond in writing back to the owner. The Hub/Program Center Director can either:
 - 1) Affirm the withdrawal of the right to retain Excess Income;
 - 2) Reverse that decision; or,
 - 3) Where appropriate, request additional information from the owner.

VI. TREATMENT OF EXCESS INCOME PREVIOUSLY COLLECTED

- A. Owners who were authorized to retain Excess Income pursuant to Section 227 of the Department's Fiscal Year 1999 Appropriations Act, P.L. 105-276 effective October 21, 1998 but who remitted the Excess Income to the Secretary may request a refund of the Excess Income effective October 21, 1998 provided the owner is in compliance with the requirements of Notices 99-28 and 00-17.
- B. Owners should submit their request for a refund to their local HUD office. The request should include documentation that the owner is in compliance with Notices 99-28 and 00-17. Once a determination is made by the local HUD office

that the owner is in compliance with the previous Notices, a copy of the owner's request along with a recommendation from the Hub/Program Center Director should be forwarded to the office of the Assistant Chief Financial Officer for Accounting; attention: Wallace Garner, Director, Accounting, Monitoring and Analysis Division in Headquarters.

- C. Refunds of Excess Income previously remitted to the Secretary will be made from amounts in the Rental Housing Assistance Fund and/or the Flexible Subsidy Fund in accordance with Section 861(b) of the American Homeownership and Economic Opportunity Act of 2000, P.L. 106-569 effective December 27, 2000.

VII. REPORTING REQUIREMENTS

- A. Remitting Excess Income to HUD: All Excess Income that owners are not authorized to keep is the property of the Federal Government.
 - 1. It must be remitted to HUD monthly without any delay for any reason.
 - 2. Multifamily Housing will turn over to the Enforcement Center, for appropriate action, all cases where owners, their managing agents, or others have improperly retained Excess Income.
- B. Accounting
 - 1. The collection and retention of Excess Income by the owners of eligible projects shall be treated as follows in the required annual audited financial statements.
 - a. Retained Excess Income considered Rent Revenue should be booked using Account No. 5194, "Retained Excess Income."
 - b. Excess Income remitted to HUD must be disclosed by the auditor in Account No. 5191, "Excess Rent".
 - c. Nonprofit owners subject to the Single Audit Act and OMB Circular A-133 need to include retained Excess Income in the formula used to calculate expended federal assistance.

- d. If an owner retains Excess Income without prior authorization from HUD, or uses Excess Income for unauthorized purposes, it should be reported as a finding in the annual audited financial statements.

NOTE: Funds that the owners are authorized to retain for non-project use are not considered distributions to the owners. These funds should not be shown on the computation of surplus cash.

- 2. The above accounting procedures do not apply to non-insured State Agency projects whose mortgages are assisted under the Section 236 program.

- C. Other Reporting Requirements: Within the deadlines as may be established by HUD for the submission of the annual audited financial statements, the owners of eligible projects shall provide the local HUD Office, on an annual basis, two copies of a brief narrative description of the amount of Excess Income retained during the prior Fiscal Year of the project and the uses made of that retained Excess Income. On a case-by-case basis, HUD may require more detailed information.

The narrative report should be one page in length and must contain the following certification:

"I certify that: (1) the amount of Excess Income retained and used was for the purpose approved by HUD; (2) all eligibility requirements for retaining Excess Income were satisfied for the entire reporting period; and (3) all the facts and data on which this report is based are true and accurate. **Warning:** HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties (18 U.S.C. Sections 1001, 1010, 1012, 31 U.S.C. Sections 3729, 3802)."

Failure to submit this narrative Report, or any additional information requested by HUD, could jeopardize the privilege of retaining future Excess Income.

- D. Local HUD Office Actions: The local HUD offices should review the annual descriptions for general compliance with the owner's intended uses of Excess Income and ask owners for clarification as necessary.
- E. Effective Date: This policy is effective on the date of the Notice's issuance but applies retroactively to cover Excess Income generated by owners since October 1, 2000 and for Excess Income remitted after October 21, 1998.

Public reporting burden for this collection of information is estimated to average 15 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. This agency may not collect this information, and you are not required to complete this form, unless it displays a currently valid OMB control number.

This information is collected to obtain full benefits authorized by the amended Section 236(g) of the National Housing Act. The information will enable HUD to ensure that project owners carry out their statutory obligations to remit to HUD all Excess Income that HUD has not authorized them to retain. Responses are required to obtain and retain the benefits authorized and mandated by Section 236 of the Act. The information is considered nonsensitive, and there are no assurances of confidentiality.

Privacy Act Statement: The Department of Housing and Urban Development (HUD) is authorized to collect this information by Section 236 of the National Housing Act, as amended, and the Employer Identification Number (EIN) by the Housing & Community Development Act of 1987, 42 U.S.C. 3543. The information concerning the monthly reporting of Excess Income is being collected by HUD to: (1) ensure project owners comply with the program requirements to accumulate, safeguard and pay HUD all rental charges collected in excess of the basic rental charges, (2) recover and enforce collection actions through repayment plans and/or offset of future subsidy billings in accordance with 24 CFR 17, administrative claims, and assess civil money penalties pursuant to Section 416 of the 1987 Housing and Community Development Act, as well as, (3) automate financial reporting needs. The EIN is used as a unique identifier for closer monitoring of owners and agents. HUD may disclose this information to Federal, State and local agencies when relevant to civil, criminal, or regulatory investigations and prosecutions. It will not be otherwise disclosed or released outside of HUD, except as required and permitted by law. Failure to provide the information could affect your future participation in HUD programs.

John C. Weicher, Assistant Secretary for
Housing-Federal Housing Commissioner