



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Special Attention of

NOTICE H 2011-10

All Multifamily Hub Directors
All Multifamily Program Center Directors
All Multifamily Operations Officers
All Multifamily Directors of Project Management
All Multifamily Field Counsel
All Contract Administrators
Multifamily Property Owners and Managers

Issued: June 22, 2011

Expires: June 30, 2012

Cross References:

Subject: Requirements for Documenting the Review and Setting of Rents for Commercial Space
in HUD Properties at Appropriate Levels as Approved by HUD

A. Purpose

This Notice provides guidance to HUD staff for review and approval of rent for commercial space as required in HUD Handbook 4350.1 and Regulatory Agreements. The intent of this Notice is to establish uniform documentation for the review of leases and rent charges for space established and designated as commercial.

B. Background

HUD insured and/or subsidized multifamily properties may receive non-residential rental income. Historically, commercial space in HUD multifamily properties could have been the result of a substantial rehabilitation of urban properties with existing commercial space, or as part of an intended development of a market rate property. Current use may have changed with the varying needs of the property. HUD's involvement in the adequacy of rents charged for the commercial portion of the properties is focused on: 1) financial feasibility of the property, 2) protection of HUD's interests in the property due to the encumbrance of a commercial lease on our property; and 3) ensuring that any housing subsidy for the residents of the property is not being used for the benefit of the commercial tenants. Furthermore, in the instance of a subsidized property, it can be the case that non-residential commercial space rents are below market because the primary purpose is to provide a benefit to the tenants.

The standard Regulatory Agreement requires prior written approval from HUD before the project Owner may enter into a lease or perform structural alterations to the property for market rate properties. HUD Handbook 4350.1, Chapter 7, Section 8 (Charges for Commercial Facilities), requires Owners to set rents at least at levels that will cover the commercial space's share of project debt service and operating expenses when processing budget-based rent increases. It also provides guidance that project managers may take into consideration when reviewing commercial rents, and

discusses two exemptions (less than break even or benefit to project tenants) and certification requirements when an identity-of-interest (IOI) relationship is involved. The IOI relationship is documented as part of the overall application approval and disclosure processes discussed elsewhere. Any lease arrangements involving IOI relationships need to be labeled on the appropriate appendix and schedule.

Form HUD-92458, Rent Schedule Low Rent Housing, Part E provides for the information on commercial rents. By signing this form, Owners with lender approval are certifying: 1) that the proposed rents are the amounts to be charged, 2) how that relates to potential (i.e., market), 3) what is included/excluded in services, 4) that is a non-revenue producing space; and 5) that is a commercial space including the amount of square footage used. (Note: Handbook 4350.1, paragraph 7-41 refers to Part C of form HUD-92264, Multifamily Summary Appraisal Report, which serves as a benchmark for comparison to current use).

From these sources, project managers with approval from their Hub and Program Center Directors will complete documentation that the amounts to be charged for commercial space for the project being reviewed are appropriate and that the leases used conform to the Regulatory Agreement requirements. Appendices to this Notice have been developed to assist in this process.

C. Applicability

HUD staff must follow this Notice for any project subject to a Regulatory Agreement stipulating that commercial facilities shall be rented for such use and upon such terms as approved by the Secretary and for any subsidized project subject to a budget-based rent increase. Therefore, HUD must approve leases prior to execution by the Owner, and for any project seeking a budget-based rent increase that is subject to the provisions of HUD Handbook 4350.1 Chapter 7, Section 1, “Applicability,” including:

1. Section 231, and 221(d)(3) market rate projects;
2. Section 202 projects;
3. Section 213, Section 236 (including cooperatives), Rent Supplements, 221(d)(3) Market Rate and 221(d)(3) BMIR rental and cooperative projects;
4. Section 8 Loan Management Set-Aside;
5. Housing Assistance Payment (HAP) contracts; and,
6. Any project seeking a budget-based rent increase.

HUD staff must also be mindful of the requirements of Housing Notice H 11-07 “Subordination Non-Disturbance and Attornment Agreements”, as those requirements may apply. This Notice does not apply to health care facilities funded or insured by HUD.

D. Implementation

The requirements of this Notice are to be implemented when HUD approval of a lease is sought as required under the Regulatory Agreement, a budget-based rent increase is sought, or form HUD-92458 is tendered, whichever occurs first. Owners must provide a new form HUD-92458 and supporting documentation with each change in commercial lease terms, e.g., new commercial tenant, new commercial lease, or new lease terms. Project managers will complete an analysis relating the amounts being collected and projected by the Owner, comparing these amounts to debt service and operating costs as applicable or providing for an approved exemption.

E. Documentation

The following Appendices are to be used to document HUD staff review and Hub and Program Center Directors' approval of commercial rents appropriate to the multifamily project involved.

Appendix A – Analysis of Commercial Rents Relative to Project Debt Service and Operating Costs.

Appendix B – Analysis that Project is Approved for Commercial Rents Below Market.

Appendix C – Analysis that an Owner's Submission of a Proposed Commercial Lease Complies with Requirements of Regulatory Agreement.

Appendix D – Analysis that an Owner's Commercial Lease Contains all the Standard HUD Rider Provisions.

If you have questions regarding this Housing Notice, please contact your desk officer in the Office of Asset Management.

/s/

Robert C. Ryan
Acting Assistant Secretary for Housing-
Federal Housing Commissioner

**Analysis of Commercial Rents Relative to
Project Debt Service and Operating Costs**

Appendix A

Project Name _____

iREMS Number _____

Commercial Rents

1	Total non-residential monthly rental income reported in the rental agreements or on the current form HUD-92458 Part E		
2	Non-residential monthly rental income for activities not related to project design space (e.g. cellular towers)		
3	Non-residential monthly rental income for activities related to project design space intended as tenant benefit ^[1]		
4	Net non-residential monthly rental income related to project design space intended as commercial (#1 - #2 - #3)		\$0
5	Annualize commercial rent (#4 x 12 months)		\$0

Commercial Square Footage

6	Non-residential commercial space per form HUD-92458, Part E, column 3 ^[2]		
7	Non-residential square footage used for activities not related to project design space (e.g. cellular towers)		
8	Non-residential square footage used for activities related to project design space intended as tenant benefit		
9	Net non-residential commercial space (#6 - #7 - #8)		0
10	Total square footage of property per underwriting documents producing rent (form HUD-92264)		
11	Percentage of net commercial square footage to total rentable square footage		0%

Commercial Income Relative to Project Debt Service and Operating Expenses

12	Total project debt service and operating costs from prior year's financial statements ^[3]		
13	Taxes and insurance paid by commercial tenant		
14	Utilities paid by commercial tenant		
15	Operating expenses paid by commercial tenant		
16	Project debt service and operating costs to be covered by commercial income (#11 x #12 - (#13 + #14 + #15)) ^[4]		\$0
17	Excess or (shortfall) as determined by calculation (#5 - #16) ^[5]		\$0

[1] Complete and obtain hub or program center director approval for Appendix B Section A.

[2] Compare to sq.ft. with original underwriting (Part C, line 30 of form HUD-92264). If different, explain as an attachment to this schedule.

[3] Use the most recent audited financial statement submitted to the Real Estate Assessment Center.

[4] Adjust, if necessary, based on type of business occupying the commercial space. Explain.

[5] Any shortfall should be justified and approved by completing Appendix B Section B.

**Analysis that Project is Approved for
Commercial Rents Below Market**

Project Name: _____

iREMS ID Number: _____

Section A – Commercial Rents Intended as Tenant Benefit.

Total amount of rents from Appendix A, line 4 intended as a
tenant benefit. \$ _____

Description of benefits to tenants known to project manager and as accounted for in most recently
available form HUD 92458 (Parts D&E).

Are rents above all related to known tenant benefits? _____ Yes/No _____
If no, please provide explanation.

Section B – Commercial Rents at Below Market ¹ Explained other than Benefiting Tenants.

Total amount of rents shortfall from Appendix A, line 17. \$ _____

Non-subsidized, insured considerations:

Is the shortfall for a non-subsidized property? _____

If so, is the shortfall significant enough to constitute an unreasonable risk²
under the Regulatory Agreement? _____

¹ Market is documented for this analysis and review by a variety of evidence. Examples of documenting market include, but are not limited to: A current market study provided by the Owner, Agreement with the underwriting rents projected within the first 3 years of project life, survey of market conditions in the general location of the property being evaluated which is known to the project manager; and documentation such as current rental ads for properties within the neighborhood, etc.

² Unreasonable risk is a matter of judgment, but is defined for purposes of this analysis and review as any shortfall which if eliminated or reduced by increased commercial rents would contribute sufficient funds to project operating income so that the shortfall from the commercial rents is not causing operating funds to be negative.

If so, describe what remedies will be taken (also document in iREMS in the problem statement).

Subsidized considerations:

Is the shortfall for a subsidized property? _____ Yes/No _____

If so, has the Owner certified in the most recently submitted form HUD 92458 that he/she has taken or is taking all reasonable steps to lease the space at market or break-even rates and that the reduced rates will not jeopardize the financial condition of the project. _____ Yes/No _____

Is the source of the rents for subsidized property an Identity-of-Interest (IOI)? _____

If yes, is rent being received despite shortfall from Appendix A analysis at market? _____

If shortfall in rent from IOI, who is paying at below market amounts, describe what remedies will be taken (also document in iREMS problem statement)?

Prepared by: _____

Date: _____

Approved by: _____

Date: _____

Analysis that an Owner's Submission of a Proposed Commercial Lease Complies with Requirements of Regulatory Agreement

Note: This analysis is prepared by the project manager and approved by the Hub or Program Center Director from information in the proposed leases submitted by the Owner. Retain submissions and documents (e.g., proposed leases, comp studies, construction plans) used to support answers to questions listed below.

1. Project Name: _____
2. Project iREMS ID Number: _____
3. Name of Tenant: _____
Is tenant an Identity-of-Interest? _____
Trade Name: _____
Parent Name: _____
4. Type of Lease (e.g., store, day care center, pharmacy). _____

5. Location description _____

6. Square footage (should agree with other disclosures per forms HUD 92264; 92458).

(Explain if
different) _____

7. Rent:
Amount \$ _____ Describe how determined

(i.e., Rent per sq. ft./Minimum Annual
Rent/Initial Term/Renewal Term(s)/CPI escalation (or equivalent i.e., Porter's Wage,
Operating)/Percentage (Cap, if any)/Tax Escalation/Insurance Escalation/Utilities/Other).
8. Describe Market Comparables evaluated and assessed.

(e.g., Comparable properties in area, studies, similar leases, rental range quotes, competitive
submissions).
9. Allowances by Landlord (Total Value \$) (Construction/Moving Free Rent/Other (i.e., lease
takeover)).

10. List any financial or non-monetary benefits to the project.

11. List other commercial tenants at project if any (Note: include at a minimum the size of the premises and sq. ft. used, if significant, a separate Appendix C for this commercial tenant should be prepared).

12. Detail any proposed construction. Disclose, discuss, and resolve any concerns specifying how they will be addressed if proposed lease is going to be accepted. (Include alterations, modifications, additions, build-outs, renovations). State whether work is structural or non-structural and its impact to the building. State whether work involves asbestos or other environmental concerns.

13. Identify whether lease involves a conversion of residential units to commercial use and evaluate impact. _____

14. Review Use (Permitted use/Restrictions on Tenant's use/Restrictions on Landlord's use) and evaluate impact. _____

15. Review if lease results in decreased use or access by residential tenants and evaluate impact.

16. Review who is responsible for repairs and maintenance (tenant or landlord) and evaluate impact.

17. Review Rent Abatement and Rent Set-Off conditions (Other than pro-rata rent abatement in the case of partial casualty with termination or abatement on restoration) and evaluate impact.

18. Identify any lease provision (including schedules, exhibits, attachments and riders) that conflict with the terms of the Mortgage and Regulatory Agreement. An existing conflict may be

resolved by modifying the lease using a HUD rider which will control so long as HUD maintains its interest in the project and evaluate impact.

19. Disclose the existence of related documents not included in the submission package (Memorandum of Lease; Guaranty of Lease, Tenant Estoppels' Certificate, Amendments, if any, Guaranty, if any).

20. Provide any other pertinent information that may bear upon HUD's review of the proposed lease and related transaction.

21. A statement indicating whether the project is in default and how this lease proposal will have any effect.

Prepared by: _____

Date: _____

Approved by: _____

Date: _____

Analysis that an Owner's Commercial Lease Contains all the Standard HUD Rider Provisions

Note: In reviewing leases against the following required provisions, the reviewer needs to identify the provision from the checklist that is not in the lease and explain why the lease would still be acceptable. Otherwise **all** of the following provisions should be present in the lease. The provisions in *italics* may be present in different parts of the lease depending on whether it is a general provision or just a parking garage provision.

Project Name: _____

iREMS ID Number: _____

1. The lease shall not be modified or terminated except for a breach of covenant thereof without the prior written consent of the mortgagee and HUD.
2. *There shall be no assignment or subleasing of any portion of the leased premises without the prior written consent of the mortgagee and HUD.*
3. *The lease may be terminated, at the option of HUD, in the event the Secretary becomes mortgagee or Owner of the property.*
4. The use of the leased premises as initially approved by HUD shall not be changed without the written consent of HUD.
5. In the event that rental rates under lease are stated in other than a fixed dollar amount, such as a lease specifying rents based on a percentage of the income accruing from the business for which the premises were leased, a provision should be included fixing the minimum dollar amount as an annual rent.
6. In the event of any conflicts between the terms of the lease and the HUD-insured Mortgage, Mortgage Note, or Regulatory Agreement, the terms of the HUD-Insured Mortgage, Mortgage Note, or Regulatory Agreement shall remain in control.
7. Landlord and Tenant acknowledge that the mortgagee and HUD have the right to apply the money derived from any hazard insurance proceeds on the property to the reduction of the debt. The lease shall not obligate the landlord to rebuild or restore the premises in the event that all or any of the buildings covered by the mortgage shall be destroyed or damaged by fire or casualty, without the prior written approval of the mortgagee and HUD. Either party may terminate the lease, in the event that insurance proceeds are not made available for repairs or restoration.
8. Landlord and Tenant acknowledge that the mortgagee and HUD have the right to apply the money derived from any award of damages in connection with condemnation or a taking of the property by eminent domain to the reduction of the debt. The lease shall not obligate the landlord to rebuild or restore the premises in the event that all or any of the buildings covered by

the mortgage shall be condemned or taken, without the prior written approval of the mortgagee and HUD. Either party may terminate the lease, in the event that any award of funds are not made available to make the premises suitable for the use intended under the lease.

9. Landlord and Tenant acknowledge that all rents, profits, and income payable to the landlord are assigned to the mortgagee and HUD for the purposes of discharging the landlord's debt and that the landlord has permission to collect such rents, profits and income from the tenant so long as no default exists under the project's loan documents. In the event of such default, the tenant shall, upon written notice from the mortgagee and HUD, pay all rental charges directly to the mortgagee, HUD or another entity designated in such notice.
 10. Tenant covenants that it will not voluntarily create or permit to be created against the property any lien or encumbrance nor make a pledge or an assignment of any interest in the premises.
 11. Any provision in the lease, which requires the landlord to indemnify or hold harmless the tenant, shall be null and void and have no force or effect, for so long as the mortgage on the property is either insured or held by HUD or HUD has an Ownership interest in or possession of the property.
 12. Tenant agrees not to seek to recover any damages, costs or expenses from the project, the project's assets, or HUD, for so long as the mortgage on the property is either insured or held by HUD or HUD has an Ownership interest in or possession of the property.
 13. The lease shall not become effective or legally binding until approved in writing by HUD.
 14. Additional HUD Rider Provisions for Parking/Garage Leases:
 - A. The tenant shall not charge rental rates in excess of those as processed by the mortgagee and HUD, without prior written permission of the mortgagee and HUD.
 - B. A priority of use of the garage facilities shall be given to all residents at monthly rates not in excess of those approved by the mortgagee and HUD so long as the mortgage on the property is either insured by or held by the Secretary.
 - C. The lease shall not be modified nor may it be terminated (except for a breach of covenant thereof or except in those leases containing a non-disturbance provision) without the prior written consent of the mortgagee and/or HUD.
 - D. *The tenant may not assign its rights under the lease nor undertake to sublease any portion of the leased premises without the prior written consent of the mortgagee and HUD.*
-

[Type text]

LIST of required provisions not included in the proposed lease (List by provision number followed by an explanation and justification of why the proposed lease is acceptable).

Provision #	(Explanation, Justification and why Acceptable)

Prepared by: _____

Date: _____

Approved by: _____

Date: _____