U.S. Department of Housing and Urban Development
Community Planning and Development

Special Attention of: Notice: CPD 98-2

All Secretary's Representatives
All State/Area Coordinators Issued: March 18, 1998
All CPD Division Directors Expires: March 18, 1999
All HOME Coordinators
All HOME Participating Jurisdictions

Cross Reference: 24 CFR Part 92
Supersedes 94-12

SUBJECT: Allocating costs and identifying HOME-assisted units in multi-unit projects.

I. PURPOSE

This Notice provides guidance to participating jurisdictions (PJs) who will use HOME funds, in combination with other funds, to develop multi-unit rental and homeownership projects. Specifically, it provides guidance to HOME PJs on how to determine the minimum number of HOME-assisted units in such projects and how to allocate costs to the HOME Program for these types of development. This Notice also describes a PJ's option to designate and track HOME units through a system of "fixed" HOME rental units or "floating" HOME rental units.

II. BACKGROUND

The HOME Program distinguishes between those units in a project that have been assisted with HOME funds and those that have not. This distinction differs from the Community Development Block Grant, the Rental Rehabilitation Program and other programs of the Department with which PJs may be familiar, in which entire buildings (and every unit therein) are considered "assisted" when one dollar of Federal funds is invested in the building. HOME funds may only be expended for units that are or will be occupied by families at or below 80% of median income and that meet the HOME affordability requirements. However, HOME funds may be invested in a mixed-income project to assist only a portion of the units in a project. Consequently, it is necessary to distinguish between HOME-assisted and other units.

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This Notice outlines the method that PJs must use to determine the minimum number of units that must be designated HOME-assisted. In general, this designation will be based on the actual HOME investment in a unit or project. A PJ may choose to require a greater number of units to be designated as HOME-assisted, to maximize the number of affordable units in the jurisdiction over time.

III. FIXED AND FLOATING HOME DESIGNATIONS FOR RENTAL UNITS

PJs may, on a project by project basis, choose to use either a "fixed" or "floating" HOME-assisted designation for rental units.

A fixed designation means that the PJ determines from the outset which units are "HOME-assisted" units. For instance, in a 10-unit rental project, if the PJ designates units A, B, C, D and E as the HOME-assisted units, these specific units (A through E) remain the HOME-assisted units throughout the period of affordability.

A "floating" designation provides PJs the flexibility to maintain a certain number of HOME-assisted units throughout the affordability period, although the specific unit(s) so designated may vary with availability. In the previous example, the PJ would designate five units as "HOME-assisted" units, and at any given point in time throughout the period of affordability, five units must have the HOME-assisted designation, and be occupied by HOME income-eligible tenants. The substituted units must be at least comparable in terms of size, features and number of bedrooms to the originally designated units. A system of floating units is desirable when PJs want to ensure that assisted units are indistinguishable from and interchangeable with market-rate units. In addition, the system of floating units provides consistency with the system required in projects developed with Low Income Housing Tax Credits.

HOME Rental Project Rules. Each HOME rental project is subject to rent and occupancy requirements:

Low HOME rent units. Twenty percent of the HOME-assisted units in each rental project containing five or more HOME-assisted units must be occupied by very low-income families (i.e., families with incomes that do not exceed 50% of the area median income). These units must bear rents no greater than: (1) 30% of the tenant's monthly adjusted income; (2) 30% of the gross income of a family at 50% of area median income, adjusted for family size; (3) in units receiving Federal or State project-based rental assistance in which the very low-income family pays not more than 30% of the family's adjusted income, the maximum rent allowable under the Federal or State project-based rental assistance subsidy program.

High HOME rent units. The remaining HOME-assisted units in each project may be occupied by families with incomes up to 80% of the area median[1] and must bear rents no greater than the lesser of: (1) the Section 8 Fair Market Rents (FMRS) (or area-wide exception rents for existing housing) minus tenant-paid utilities; or (2) rents that are 30% of adjusted income for families at 65% of median income minus tenant-paid utilities.

Temporary noncompliance with the project income targeting requirements is permissible when the non-compliance is caused by an increase in a tenant's income. When the income of a tenant increases above 80% of area median income and the project has "fixed" HOME-assisted units, then the next available HOME-assisted unit must be rented to a HOME income-eligible tenant. When the project has "floating" HOME-assisted designations, the next comparable unit that becomes available in the project must be rented to a HOME income-eligible tenant. (That unit then becomes the HOME-assisted unit, and the rents must be structured accordingly.) When the income of a tenant in a HOME-assisted unit rises above 80% of area median, that tenant is required to pay 30% of his or her income for rent except that, in projects where HOME units float, the tenant's rent may not exceed the market rent for comparable, unassisted units in the neighborhood.

If the income of a tenant in a low HOME rent unit increases (but does not exceed 80% of area median income), then the PJ must rent the next available comparable unit (for "floating" unit projects) or HOME-assisted unit (for "fixed" unit projects) to a very low-income tenant. The unit occupied by the tenant whose income increased becomes a high HOME rent unit and the corresponding rent must be charged.

IV. ALLOCATING COSTS TO HOME-ASSISTED UNITS

HOME may only pay actual costs of HOME-assisted housing. If the units in a project are comparable (in terms of size, features and number of bedrooms), then the actual costs can be determined by pro-rating total (HOME-eligible) development costs. HOME funds could pay the pro-rated share of the HOME-assisted units. When units are not comparable, the PJ must allocate the HOME costs on a unit-by-unit basis, charging only actual costs to the HOME Program, as described below. Because units in rental projects with-the "floating" HOME designation must be comparable, a PJ should always pro-rate costs in these projects. When units are generally comparable but vary slightly in size or amenities, a combination of the two approaches may be used.

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[1] Because 90% of the occupants of HOME-assisted rental units and households assisted with HOME tenant-based rental assistance must have incomes that are no greater than 60% of the area median income, most of these units, as a practical matter, must initially be rented to families with incomes at or below 60% of area median income.

A. Basic Considerations

Comparability

Unit Size. Comparability in size is defined by the bedroom count and square footage of individual units. Not all units with the same number of bedrooms are comparable in size. If there is a substantial difference in the square footage of two units with the same number of bedrooms, the units are not considered comparable.

Amenities. Comparability in amenities means similar fixtures, appliances and other features. In many mixed-income projects, to demand varying rents, the quality and types of amenities may vary among units. For instance, a project manager can demand a higher rent for a unit with wall-to-wall carpeting, garbage disposal, dishwasher and finer fixtures than for a unit without these amenities. This type of project does not typically have comparability of units, unless there is an equal distribution of assisted and non-assisted units that have these amenities.

Maximum per unit subsidy

The average per-unit HOME investment (whether it is derived on a unit-by-unit cost allocation basis, or as a pro-rated share of the total costs) may not exceed the HOME maximum per unit subsidy.[2] When a PJ is pro-rating costs, the total HOME investment (including acquisition, development hard costs to construct or rehabilitate, project soft costs and all relocation costs) divided by the number of HOME-assisted units yields the per unit HOME investment, which cannot exceed the HOME maximum per unit subsidy. When it is allocating actual costs on a unit-by-unit basis, the actual per unit cost may not exceed the HOME maximum per unit subsidy.

Common Costs

Common costs are costs incurred for acquisition of improved or unimproved real property that benefits all residents of units in a project, rehabilitation or construction of shared systems (heating, plumbing, roofing) or shared facilities (community rooms, laundry facilities located in residential buildings); and on-site improvements. Costs associated with a project's on-site management office or the apartment of an resident manager may be counted as common costs. The manner in which the costs for common elements of a project may be charged is dictated by the method chosen for allocating costs.

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[2] This limit is equal to the per-unit dollar limit established by HUD for elevator-type projects involving nonprofit mortgagors under section 221(d)(3) of the National Housing Act that apply to the area w here the project is located.

B. Option 1: Pro-rating Cost Allocation Method

To use the pro-rating method of allocating costs, there must be comparability between the total inventory of HOME-assisted and non-assisted units in a project. For example, in a 12 unit building in which half the units are one-bedroom and half are two-bedroom and the units of each bedroom size are approximately the same square footage, there should be an equal proportion of one- and two bedroom units in the assisted and nonassisted units. Similarly, if one-third of the units are HOME-assisted, designation of two 1-bedroom units and two 2-bedroom units would be required to achieve comparability in the distribution of units.

When assisted and non-assisted units are comparable, total eligible development costs (including acquisition, development hard costs to construct or rehabilitate the unit, and project soft costs excluding relocation costs) may be pro-rated in order to determine the HOME share of the total costs. Thus, all eligible project costs may be distributed between the HOME Program and other funding sources, provided that the HOME share does not exceed the maximum per unit subsidy limit. However, each eligible cost need not be paid as a proportionate share of each funding source. This means HOME can pay any eligible cost and the PJ can pro-rate the HOME share, in relation to the total eligible costs to determine the minimum number of HOME-assisted units. For example, if a PJ acquires land with $100,000 in HOME funds, and uses $900,000 in private funds to construct a multi-family rental property on the site, then a minimum of 1/10 ($100,000/$1,000,000) of the units in the project must be designated HOME-assisted. When the assisted and nonassisted units are comparable in size and distribution, a prorated share of the cost of common elements attributable to the HOME-assisted units may be paid with HOME funds. For example, a PJ replaces a heating system, installs new water and waste lines and replaces the roof in a 24-unit building with 8 HOME-assisted units that are comparable to the non-assisted units in the building. The PJ may pay one-third of the total common costs because one-third of the units are HOME-assisted.

The ratio of the HOME investment to the total eligible development costs is equivalent to the ratio of the minimum number of units that must be HOME-assisted to the total number of units. Because all relocation payments and other relocation assistance that the PJ wishes to treat as project costs may be paid in full by the HOME Program, these costs are subtracted from both the HOME investment amount and the total eligible development costs for the purposes of pro-ration and then added back into the amount of the HOME investment.[3] This principle can be expressed in this way:

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[3] Relocation costs associated with tenants residing in non-HOME units are HOME-eligible costs. These costs are divided among the HOME-assisted units and added to the per-unit HOME subsidy amount. Thus, the amount of relocation assistance that can be provided with HOME funds is constrained by the maximum per-unit subsidy limits.

HOME-Assisted Units : Total Number of Units
equals
HOME Investment (excluding relocation): Total Development Costs (excluding relocation)

For example:

A PJ develops a project with 20 comparable 2-bedroom units, and wants to designate half of the units HOME-assisted. The total eligible development cost (including relocation project costs) is $500,000. Several tenants residing in the building will require relocation assistance at a total cost of $40,000. No other relocation costs will be incurred.

What is the maximum amount the PJ may charge to the HOME Program? The total eligible development cost minus relocation is $460,000. Since half the units are HOME-assisted, half of this amount ($230,000) may be charged to HOME. All the relocation costs ($40,000) may then be added to this. In total, HOME may pay as much as $270,000, provided the per unit subsidy does not exceed the HOME maximum per unit subsidy for this PJ.

In this instance, how much is the per unit subsidy?

The total HOME investment (including relocation costs) divided by the number of HOME-assisted units yields the per unit HOME investment. (In this instance, $27,000 per unit.)

A PJ wants to acquire and rehabilitate a 60-unit vacant building. The units will be comparable in terms of bedroom size, square footage, unit distribution and amenities. The total acquisition and development costs are $1,000,000. The PJ will use $200,000 of HOME funds toward rehabilitation.

What is the minimum number of units that the PJ must designate as HOME-assisted?

Because the proportion of total acquisition and development costs to HOME funds is 5:1 ($1,000,000 : $200,000), the proportion of total units to HOME-assisted units must also be at least 5:1. This means there is at least one HOME-assisted unit for every 5 units in the building, or one-fifth. For a 60-unit building, there are 12 HOME-assisted units (one fifth of 60 is 12).

If the PJ is developing an occupied project in which some of the units are occupied by over-income tenants, it may not invest HOME funds in those units.[4] If the units are comparable, the PJ can ascertain the maximum amount of its HOME investment in this project by determining the ratio of units that are occupied by income-eligible tenants. That same ratio of the costs may be charged to HOME. For example:

[4] In such instances, the PJ may choose to displace the over-income tenants. The displacement would trigger the relocation requirements of &167;92.353.

A PJ wishes to acquire a building with 20 comparable units, 10 of which are currently occupied. The PJ certified the incomes of each of these occupied units and found the following:

- 5 units have tenants whose incomes are above 80% of the area median income,
- 1 unit is occupied by a tenant whose income is at 74% of the area median income,
- 4 units have tenants whose income is below 60% of the area median income.

The total development cost of this project is $700,000. The HOME maximum per unit subsidy is $50,000. The PJ does not want to displace any current residents, and wants to invest as much HOME funds in this project as possible.

What is the maximum amount of HOME funds the PJ may invest?

The PJ may not invest any HOME funds in the 5 units that are occupied by tenants who are not low-income (whose incomes are above 80% of the area median income). It may invest HOME funds in all of the remaining 15 units. Since 15 HOME-assisted units is 75% of the total units, 75% of the total HOME-eligible development costs ($525,000) may be paid with HOME funds. The PJ must rent the 10 vacant units to income eligible tenants and at least 3 of the 15 units must be occupied by families below 50% of median income.

C. Option 2: Unit-By-Unit Cost Allocation Method

When the HOME-assisted and non-assisted units in a project are not comparable in terms of distribution or size, the PJ must determine and charge the HOME Program for the actual costs incurred for the acquisition and development of the HOME units, plus any common costs that can be attributed to the HOME portion of the project.

To allocate these costs, the PJ must designate the HOME-assisted units, develop a proforma for the assisted units, and track the costs for each unit. Common costs attributable to HOME-assisted units are determined by calculating the total square feet in HOME units as a percentage of the total square feet in the project. HOME funds can pay for that percentage of the common costs.

The actual cost for each unit is charged to the HOME Program, provided the actual cost does not exceed the maximum per unit subsidy. The actual cost is charged, regardless of whether it is more or less than the pro-rated cost would be.

A PJ will construct a new 60-unit, mixed-income development. Twenty of the units will be luxury units, with wall-to-wall carpeting, brass fixtures and saunas. The total development costs for these units will be $2,000,000.

Twenty units will have somewhat fewer amenities and will be marketed to middle income families with incomes between 80 and 120 percent of the area median income. The total development cost of these units will be $1,500,000.

Twenty units will have even fewer amenities and will be rented to low- and very low-income families. The total development cost of these units will be $1,000,000.

What is the maximum amount of HOME funds the PJ can invest?

Because the units in this project are not comparable, the PJ may use HOME funds only the cost of the units that will meet the HOME requirements. Therefore, it may invest up to $1,000,000 in HOME funds to construct the 20 units for income-eligible families, provided that the PJ's per unit subsidy limit equals at least $50,000. All 20 units will be designated as HOME-assisted.

A PJ will use $200,000 of HOME funds and $100,000 of local funds to rehabilitate a 15-unit building it already owns. Ten of the 15 units are 2-bedroom units and will not be HOME-assisted. The remaining 5 units are efficiencies and will be HOME-assisted. The total rehabilitation cost is $300,000.

What portion of these costs can be paid with HOME funds?

HOME can pay the actual rehabilitation costs, up to the per unit subsidy limit, of the units designated as "HOME-assisted."

D. Special Case: Projects With Owner-Occupied Units

HOME funds may be used to assist projects that contain a single owner-occupied unit and one or more rental units. As with other projects, costs are allocated based upon one of the methods outlined above. However, the PJ and/or the owner also must decide which units will be HOME-assisted and whether the project will be a homeownership project, a rental project or a combination homeownership and rental project. In making this determination, the PJ must consider the activity being undertaken, the number of HOME-assisted units in the project and whether the owner-occupant or homebuyer qualifies as low-income.

If an owner-occupant or homebuyer is receiving HOME assistance to purchase or rehabilitate a building with 2 or more units and in which he or she will reside as a principal residence, the PJ must determine the number of units that must be designated as HOME-assisted based on one of the allocation methods outlined above.
Simple prorating may not be appropriate in such cases, because the owner-occupied unit may contain more and/or more expensive amenities than the rental units. Once it has determined the number of units that must be HOME-assisted, the PJ and/or the owner may decide which units are to be so designated. If the owner-occupant or homebuyer is not low-income, then the HOME funds may only be used to assist the rental units in the building.

If the owner-occupant or homebuyer is low-income, the PJ may choose which units to designate as HOME-assisted. For instance, if only one unit must be designated as HOME-assisted, then the HOME unit could be the owner-occupied unit or one of the rental units (as long as the amount of HOME assistance does not exceed the actual cost of rehabilitating the rental unit). If more than one unit must be designated as HOME-assisted, the PJ and/or owner may decide to designate either the owner-occupied unit and one rental unit or two rental units as HOME-assisted. If any rental units are designated as HOME-assisted, then the HOME income targeting and affordability requirements apply throughout the period of affordability.

A PJ is assisting an low-income owner-occupant to rehabilitate her three-unit property. The current tenants in both rental units qualify as low-income. The total rehabilitation cost will be $45,000. The PJ will provide a $30,000 loan and the owner will obtain a $15,000 private rehabilitation loan. The owner's unit is comparable to the rental units in terms of bedroom size, square footage and amenities. Consequently, the HOME costs can be prorated.

Because HOME funds represent two-thirds of the total development cost, two of the units must be HOME-assisted. The PJ may designate either the owner-occupied unit and one rental unit or the two rental units as HOME-assisted.

A PJ wants to increase owner-occupancy in a low-income neighborhood with a large inventory of vacant, 2-to-4 unit properties. Through this program it is assisting a family that does not qualify as low-income to purchase a vacant "triple-decker." The 3 units are comparable in terms of size and amenities. The total acquisition cost for the property is $120,000. The PJ is providing a deferred $25,000 HOME loan for downpayment and closing costs. Because the $25,000 in HOME assistance is less than the average $40,000 per unit acquisition cost, only one unit is required to be designated as HOME-assisted. Because the family is not income-eligible, one of the two rental units must be designated as HOME-assisted. That unit would be subject to the HOME rent requirements during the period of affordability. Because this is considered a rental project rather than a HOME h6mebuyer assistance project, the rental requirements are not permitted to lapse if the homebuyer sells the property during the period of affordability.

Section 92.254(a)(5)(ii)(A)(6) of the HOME final rule establishes special rules for cases in which HOME funds are provided to assist a low-income homebuyer to purchase single-family properties containing two to 4 units. The PJ must allocate HOME costs to determine whether HOME funds will assist the homebuyer to acquire more than one unit. If HOME funds are used to assist the acquisition of only one unit and that unit will be the principal residence of the low-income homebuyer, the affordability requirements of _92.254 apply only to that unit. However, if HOME funds are also used to assist the low-income homebuyer to acquire one or more of the rental units, the rental affordability requirements of _92.252 apply, except that the PJ may impose resale or recapture requirements on all assisted units. If the resale restrictions are used, the affordability requirements on all assisted units continue for the affordability period. If recapture restrictions are used, the affordability requirements on the assisted rental units may be terminated, at the PJ's discretion, upon recapture of the HOME investment. From a practical standpoint, imposition of the resale restriction on these types of homebuyer properties makes resale very difficult; in these instances, the recapture provisions are usually the better option. If the homebuyer is not low-income or the PJ otherwise decides to assist the acquisition of only the rental units, then the requirements of _92.252 would apply and the owner-occupied unit would not be subject to the income targeting or affordability provisions of _92.254.

> A PJ assists a low-income family to purchase a row-house that contains a basement apartment. The total acquisition cost (including closing costs is $95,000). The PJ is providing a deferred $15,000 HOME loan for downpayment and closing costs. The basement apartment constitutes only one-third of the total living space and contains fewer amenities.
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> The unit-by-unit cost allocation determines that the costs attributable to the basement unit equal $30,000 and that one of the 2 units must be HOME-assisted. Because the HOME subsidy is less than the actual cost of the smaller unit, the PJ may designate either the homebuyer unit or the rental unit as HOME-assisted.
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> In this instance, the PJ designates the homebuyer's unit as HOME-assisted. The HOME rental requirements will not apply to the basement unit.