



October 26, 2018

Rural Development

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TO: State Directors
Rural Development

ATTN: Program Directors
Multi-Family Housing

FROM: Joel C. Baxley /s/ *Joel C. Baxley*
Administrator
Rural Housing Service

SUBJECT: Guidance on Use of Rent Incentive Options
in Multi-Family Housing Properties

PURPOSE:

The purpose of this Unnumbered Letter is to provide guidance in the development of rent incentive options in situations where multi-family owners or management agents can be allowed to address a potential vacancy problem immediately or as part of a Servicing Work Out Plan (SWOP) in situations where multi-family properties are experiencing high vacancies. For the last two fiscal years a pilot of this policy was tested in four States; Ohio, New York, North Carolina and Florida with good utilization and positive results of increased occupancy. Borrowers and Agency staff have commented that they find the program beneficial and hope that it continues.

BACKGROUND:

Many Rural Development Multi-Family Housing (MFH) properties that are experiencing vacancies need to attract applicants in order to improve cash flow and maintain financial viability. In some rental markets, a short-term rent incentive of no more than three months may be useful in improving occupancy and project cash flow. This may mean charging less than basic rent for an apartment unit, one-month free rent or no security deposit. The Borrower is not required to submit a revised mid-term budget reflecting the rent concessions, however, they are required to discuss short-term rent incentives with their Servicing Official and obtain Agency approval prior to implementation. Short-term rent incentives are not a cure for long-term soft market conditions. In these situations, a rent incentive lasting longer than three months may be required, and the Borrower would need to enter into an agreement with the Agency prior to implementing rent incentives for a period greater than three months. This servicing tool is temporary in nature to help in determining a long-term strategy for managing the asset.

EXPIRATION DATE:
October 31, 2019

FILING INSTRUCTIONS:
Housing Programs

OPTION 1 – FLEXIBLE RENT INCENTIVE:

To be utilized in situations where multi-family owners or management agents are allowed to address a potential vacancy problem immediately, increasing occupancy and project income outside the purview of a SWOP.

In the flexible rent incentive plan, the Borrower will utilize funds that would otherwise constitute the approved proposed budgeted vacancy allowance plus the owners return on investment (or Return to Owner (RTO)) to pay the project the difference between the basic rent and the rent incentive rent (the amount of rent incentives). There should be no negative financial impact on the MFH property by implementation of this incentive and no project funds should be used to fund rent incentives. Any incentives paid above the total budgeted vacancy plus RTO will be reimbursed or paid by ownership to the project.

EXAMPLE: Form RD 3560-7, Proposed Project Budget

PART I - 8.	LESS (<i>Vacancy and Contingency Allowance</i>)	\$2500 (6%)
PART 1- 23.	RETURN TO OWNER	\$6041
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	TOTAL FLEXIBLE RENT INCENTIVE AVAILABLE	\$8541

CRITERIA:

A MFH property may utilize a flexible rent incentive if the property has a 12-month historical vacancy rate of less than 10 percent for properties of 16 or more units, or less than 15 percent for properties of fewer than 16 units **or** if vacancy caps exceeds 10 or 15 percent and ownership limits proposed vacancy rate to the established aforementioned caps.

The Borrower or management agent submits an annual budget for approval that allows for flexible rent incentives in an amount up to the total budgeted vacancy rate (or capped at 10 percent or 15 percent vacancy rate based on property size, if historical vacancy exceeds caps) and RTO. The proposal to have the budget reviewed and approved with a flexible rent incentive would then be disclosed in the accompanying budget narrative. Once approved, the rent incentives will only be offered to new applicants during that budget year, with the option to renew annually.

The Agency, by approving the budget, automatically grants the authorization to the Borrower and or management agent to exercise flexibility in immediately responding to vacancy losses and any experienced market resistance to the affordability of existing rents by offering leasing and rent incentives to immediately restore sustaining occupancy rates. Agency staff will need to carefully review and analyze the proposed budgets to ensure that capping projected vacancy, if not achieved, will not be detrimental to the project cash flow and operations.

OPTION 2 – RENT INCENTIVES IN A SWOP:

In the rent incentive SWOP, the Borrower will utilize funds that would otherwise constitute owner return on investment (or RTO) to pay the project the difference between the basic rent and the

rental incentive rate (the amount of rent incentives). There should be no negative financial impact on the MFH property by implementation of this SWOP and no project funds should be used to fund rent incentives. These SWOPs must be carefully monitored and controlled using the approval conditions listed below.

All approved conditions must be met, without exception, unless a variation from these conditions is approved by the National Office prior to the SWOP agreement.

CRITERIA:

A MFH property may utilize a rent incentive SWOP if the property has a 12-month historical vacancy rate of 10 percent or more for properties of 16 or more units, or 15 percent or more for properties of fewer than 16 units. Once approved, the rent incentives will only be offered to new applicants, with the option to renew annually.

CONDITIONS:

1. All rental incentives will be limited to a per unit dollar amount;
2. Per unit amount of flexible rent incentive should be outlined in proposed budget narrative. If the Borrower is unable to determine the per unit amount of the incentive needed when submitting the budget narrative (i.e. \$50; \$100), at minimum, it should state the rent incentive will not exceed the combined total of the budgeted vacancy allowance and RTO;
3. SWOP will require the Borrower to forego RTO, without exception;
4. Flexible rent incentives are not based upon income levels but, rather, on the need to fill vacant units. If the property is located in a strong market area and has a waiting list of applicants with varying income limits from which to choose on the basis of a pre-determined tenant selection criteria associated with those income levels, the flexible rent incentive should not be requested or approved within the annual proposed budget RD Form 3560-7;
5. There will not be separate or tiered rent incentives based on an applicant's income level. For example, a very low-income applicant would not receive a \$100 incentive while a low or moderate-income applicant would receive only a \$50 incentive. If the Borrower/management agent set the incentive at \$100, then all vacancies would be filled using a \$100 incentive. If it is determined that it is or should be \$50, then all vacancies would be filled using a \$50 incentive, regardless of the applicant's income profile;
6. The annual proposed vacancy should be budgeted following the Agency's guidelines 7 CFR 3560.303(a)(2) and as outlined in HB-2-3560 4.26(B) and the budgeted vacancy allowance should not be artificially inflated;
7. Flexible rent incentive budgeted vacancy allowance for subsequent years will be actual 12-month vacancy or half of previous year approved proposed vacancy whichever is higher.
8. In unusual circumstances when budgeted vacancy rates exceed caps, a rent incentive SWOP must be submitted prior to receiving budget approval;
9. Management and owners will not need to demonstrate or document that they have made marketing efforts to lease the units before offering rent incentives. The Agency acknowledges that marketing is an on-going effort, more intense as vacancies exist and

- increase. If the owner is willing to forego an 8 percent cash return on qualified equity in the form of rent incentives to fill vacancies, there must be an acknowledgement that such an owner would also ensure the property was and is being proactively marketed before doing so. The flexible rent incentive budget permits the owner/management agent to respond promptly to vacancy losses without further consultation with the Agency, including but not limited to any need to document marketing efforts. Upon receipt of RD Form 3560-7 with annual actual income and expenses reported, the Agency will be able to readily determine advertising expenses for the incentive year having just ended and if a flexible rent incentive budget is warranted in future years;
10. SWOP will identify the other types of aggressive marketing efforts being made to improve occupancy;
 11. SWOP with rental incentives will be limited to a maximum two-year term with a market survey, recommended 3 to 5 properties, completed after the initial 10-month period to determine level of need;
 12. Assignment of Rental Assistance must follow 7 CFR 3560.257(a) through (d) and HB-2-3560, Chapter 8, paragraph 8.10;
 13. Security deposits must follow 7 CFR 3560.204 and HB-2-3560, Chapter 7, paragraph 7.8 with payment plans not to exceed three months;
 14. Rent incentive will be cancelled if the project undergoes other servicing efforts, including receipt of tax credits, a Rural Rental Housing rehabilitation loan, tools from the Multifamily Preservation and Revitalization Demonstration program, or if the project falls out of compliance with one of the above conditions, or no longer meets the criteria for a rent incentive;
 15. Lease agreements with incentive allowances will identify the full basic rent with an addendum allowing an incentive discount. After the expiration of a one-year lease during which the resident was receiving a “rent incentive”, the owner/management will have the discretion to choose to offer a new incentive to retain the resident or allow the rent to return to the normal level. This decision to renew the incentive or offer a reduced incentive will be based on recent market conditions, current vacancy level at the property, continued Agency approval of a flexible rent incentive budget or SWOP and other issues that are pertinent to the on-going operations of the property and should be limited to 2 years if possible.
 16. SWOP will require quarterly financial reports, Form RD 3560-7, “*Multi Family Housing Project Budget/Utility Allowance*,” with a narrative that identifies the breakdown of incentives by tenants, amount and month for the previous three-month period submitted to the appropriate Rural Development State/area/field office, as directed.
 17. After approval please enter the appropriate serving effort of Rental Incentive #3022 in the Multi-Family Information System. In comments please enter Option #1 or #2 to designate the approved incentive.

For fiscal year 2019 proposed budgets that have already been submitted, Borrowers may still utilize the Option 1 Flexible Rent Incentive by sending an e-mail requesting the servicing effort, to their servicing official. The servicing official will then review the conditions outlined above for

determination of approving the request. The servicing official will then notify the Borrower of the final determination.

Questions concerning the implementation of the rent incentive options should be directed to Michael Resnik, Multi-Family Housing Portfolio Management Division, at (202) 430-3114.