

the borrower to maintain the housing for low-income use that takes into consideration the economic loss the borrower may suffer by foregoing prepayment. When developing an incentive offer, the Servicing Office or other designated office must first offer incentives other than equity loans, unless it is determined that alternative incentives are not adequate to provide a fair return to the borrower, prevent prepayment of the loan, or prevent displacement of the tenants. The guidance provided in §§ 1965.213 and 1965.214 and Exhibit E of this subpart (available in any Rural Development State or District Office) will be used to determine the appropriate incentive package. Once an incentive offer has been accepted on a project, the project will be considered ineligible for future incentive offers until such time as the restrictive-use period associated with the incentive offer has expired.

#### **§ 1965.213 [Amended]**

34. Section 1965.213 is amended by redesignating paragraphs (a), (b), and (c) as paragraphs (b), (c) and (d) respectively; and by adding a new paragraph (a) and by revising the introductory text of newly redesignated paragraph (b) and paragraph (b)(1) to read as follows:

#### **§ 1965.213 Offer of incentives to borrowers.**

\* \* \* \* \*

(a) *Availability of incentives.* Incentives may be offered only if the restrictive period has expired for any RRH project loan.

(b) *Available incentives.* One or more of the following incentives will be offered to the borrower. The amount of incentives will be determined in accordance with Exhibits D and E of this subpart (available in any Rural Development State or District Office).

(1) *Equity loans.* In RRH projects, a subsequent loan may be offered for equity for the difference between the current unpaid loan balance and a maximum of 90 percent of the project's value appraised as unsubsidized conventional housing. Equity loans may not be offered unless the servicing official determines that other incentives offered under this paragraph are not adequate to provide a fair return on the investment of the borrower, to prevent prepayment of the loan, or to prevent the displacement of project tenants.

\* \* \* \* \*

Dated: May 1, 1997.

**Jill Long Thompson,**

*Under Secretary, Rural Development.*

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## **DEPARTMENT OF AGRICULTURE**

### **Rural Housing Service**

### **Rural Business-Cooperative Service**

### **Rural Utilities Service**

### **Farm Service Agency**

#### **7 CFR Part 1944**

**RIN 0575-AB93**

#### **Processing Requests for Section 515 Rural Rental Housing (RRH) Loans**

**AGENCIES:** Rural Housing Service, Rural Business-Cooperative Service, Rural Utilities Service, and Farm Service Agency, USDA.

**ACTION:** Final rule.

**SUMMARY:** The Rural Housing Service (RHS), formerly Rural Housing and Community Development Service (RHCDS), a successor Agency to the Farmers Home Administration (FmHA), amends its regulations for processing loan requests for Rural Rental Housing (RRH) assistance. This action is taken to improve loan processing procedures to better accomplish the program's purpose of providing rental housing to rural areas of greatest need.

In a future rulemaking document the comment period will be reopened for the proposed market study revisions (Exhibit A-8 of 7 CFR part 1944, subpart E) only.

**DATES:** The effective date of this final rule is June 6, 1997.

**FOR FURTHER INFORMATION CONTACT:** Linda Armour, Senior Loan Specialist, Multi-Family Housing Processing Division, RHS, U.S. Department of Agriculture, Room 5349—South Building, Stop 0781, Washington, D.C. 20250, telephone (202) 720-1608.

#### **SUPPLEMENTARY INFORMATION:**

##### **Classification**

This rule has been determined to be significant for purposes of Executive Order 12886 and therefore has been reviewed by the Office of Management and Budget.

##### **Paperwork Reduction Act**

The information collection requirements contained in this regulation have been previously approved by the Office of Management and Budget (OMB) under the provisions of 44 U.S.C. Chapter 35 and have been assigned OMB control number 0575-0047, in accordance with the Paperwork Reduction Act of 1995. This rule does not impose any new information collection requirements.

## **Civil Justice Reform**

This rule has been reviewed under Executive Order 12778, Civil Justice Reform. In accordance with this rule: (1) All state and local laws and regulations that are in conflict with this rule will be preempted; (2) no retroactive effect will be given to this rule; and (3) administrative proceedings in accordance with 7 CFR part 11 must be exhausted before bringing suit in court challenging action taken under this rule.

### **Unfunded Mandate Reform Act**

Title II of the Unfunded Mandate Reform Act of 1995 (UMRA), Public Law 104-4, establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, RHS generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires RHS to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective or least burdensome alternative that achieves the objectives of the rule.

This rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

### **National Performance Review**

This regulatory action is being taken as part of the National Performance Review program to eliminate unnecessary regulations and improve those that remain in force.

### **Programs Affected**

The affected program is listed in the Catalog of Federal Domestic Assistance under Number 10.415, Rural Rental Housing Loans.

### **Intergovernmental Consultation**

For the reasons set forth in the Final Rule related Notice to 7 CFR part 3015, subpart V, this program is subject to Executive Order 12372 which requires intergovernmental consultation with State and local officials. RHS has conducted intergovernmental consultation in the manner delineated in RD Instruction 1940-J.

**Executive Order 12778**

The Office of the General Counsel has determined that these regulations meet the applicable standards provided in section 2(a) and 2(b)(2) of Executive Order 12778. The provisions of this rule will not have retroactive effect prior to the effective date. The provisions of this rule will preempt state and local laws to the extent such state and local laws are inconsistent herewith. The administrative appeal provisions published at 7 CFR parts 11 and 780 must be exhausted before action for judicial review may be brought.

**Environmental Impact Statement**

This document has been reviewed in accordance with 7 CFR part 1940, subpart G, "Environmental Program." It is the determination of RHS that this action does not constitute a major Federal action significantly affecting the quality of the human environment and in accordance with the National Environmental Policy Act of 1969, Public Law 91-190, an Environmental Impact Statement is not required.

**Background**

RHS has recognized the need to revise the manner in which Section 515 loan proposals are selected for processing to ensure that affordable rental housing reaches areas of the greatest need. This resulted from internal reviews by the Agency and reports from the General Accounting Office, the USDA Office of the Inspector General (OIG), and the Surveys and Investigations Staff of the House Committee on Appropriations. In response to such findings, RHS published a proposed rule on January 17, 1996 (61 FR 1153). This rule proposed changes to the manner in which loans were selected for funding and complied with statutory provisions of the Housing Act of 1949 at that time. In addition, other program enhancements were proposed to improve the quality of loan underwriting. Since publishing the proposed rule, the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 1997, Public Law 104-180 (herein referred to as the Act) was enacted on August 6, 1996. The Act amended the Housing Act of 1949 and revised the manner in which RHS selects loan proposals. The provisions of the Act conflicted with many of the revisions contained in the proposed rule. As a result, the Agency is not implementing the changes affecting the priority point system which were initially proposed on January 17, 1996.

In a separate rulemaking document, published elsewhere in this issue of the **Federal Register**, RHS is implementing the provisions of the Act. These changes are effective upon publication.

This rulemaking document implements the other program enhancements proposed on January 17, 1996, which were not affected by the Act. This rulemaking action is effective June 6, 1997.

RHS is also publishing elsewhere in this issue of the **Federal Register** a Notice of Funding Availability (NOFA) announcing the application requirements for Fiscal Year 1997 Section 515 funding. Applicants for the Section 515 program should be aware that, although the implementation dates are staggered, the provisions of both rulemaking provisions published this date in the **Federal Register** and the provisions contained in the NOFA will apply to any Section 515 loan request to be processed in FY 1997.

**Implementation Proposal**

This rule includes provisions pertaining to applicant eligibility and loan processing procedures that affect loan proposals in process. All pending loan requests to be processed in FY 97 will be reviewed for compliance and eligibility based on this regulation. Details of the provisions adopted in this rule are given in the "Discussion of Comments" section.

**Discussion of Comments**

The proposed rule was published in the **Federal Register**, 61 FR 1153, on January 17, 1996, with a 60-day comment period that ended March 18, 1996. Nineteen comments were received during the comment period from RHS personnel, developers, attorneys, housing advocacy groups, and others.

As previously discussed, the revisions to the point system will not be implemented because of recent legislation that directs the Secretary to develop objective criteria for identifying and designating areas with the greatest need for Section 515 housing. We appreciate the many constructive comments that were received regarding the proposed revisions. Many of these were general comments that were helpful in developing regulations to implement the Act. We would also like to thank the RHS staff who reviewed and provided excellent comments on the draft census data and priority point scores for the revised system.

Two comments were received regarding the Agency's reserve account requirements. One commentator expressed the opinion that Agency requirements were not sufficient for the

replacement of major building components and recommended increasing the annual reserve account requirement from one percent of the RHS loan amount to an amount between five and seven percent. The second commentator mentioned the need to address reserve account requirements for participation loans. As a result, we have included guidance on reserve requirements for participation loans in this rule. In addition, we have modified the instructions for the Agency's loan agreement to ensure that reserve levels are based on the total project, regardless of whether RHS is the sole lender or is participating with other funding sources. The revised instructions require that the fully funded reserve amount be based on the project's total development cost (TDC) or the appraised value, whichever is greater, rather than on the RHS loan amount.

Comments on the major proposed changes are discussed below:

1. Section 1944.211(a)(15). Eligibility requirements for applicants with noncompliance issues or fair housing violations.

Five comments were received on this section:

Two comments pertained to paragraph (i), which provides that the State Director may request a waiver from the Deputy Administrator, Multi-Family Housing, to the requirement that applicants must be in compliance with existing workout plans for a minimum of 6 months. One commentator noted that this paragraph was inconsistent with existing Agency policy, which gives the State Director the authority to grant this waiver. This was an oversight; we have changed the appropriate paragraph to be consistent with this policy. The second commentator suggested that good faith borrowers be allowed to request a waiver themselves. We believe the decision to request a waiver should be made by the Agency; good faith borrowers should work with their local RHS servicing official, who may request a waiver from the State Director when circumstances warrant.

One commentator felt the Agency included items in the list of fair housing violations that were not found in the Fair Housing Act and suggested eliminating the Fair Housing provisions. The same commentator found certain statements to be vague and asked for a definition of several phrases, including "unusual circumstances", "in compliance with requirements of existing debts", "unacceptable compliance reviews", and "acting in good faith". Two commentators submitted language they felt would accomplish the Agency's purpose and be "defensible".

The suggested language omits the 6-month compliance period for borrowers with workout plans and instead requires only that an approved workout plan be in place; it also changes the provision that borrowers with serious violations will not be considered eligible to a provision that applicants or principals who had been debarred are eligible if the debarment period has expired.

We have made several changes to this section based on the comments we received. The suggested wording regarding debarment has been included but modified to state that applicants who had been debarred but whose debarment period has expired will be considered for eligibility, subject to all eligibility requirements. We have retained our requirement for the 6-month compliance period to help ensure the applicant is complying with the terms of the workout plan and not merely signing a token plan in order to meet eligibility requirements. We have further defined "in compliance with existing debts," "unusual circumstances," and "acted in good faith." The paragraph on civil rights violations has been revised to specify that the applicant and principals must be in compliance with the Civil Rights Act of 1964, in accordance with their Assurance Agreement, Form RD 400-4.

2. Section 1944.213(f)(3). "Build and fill" policies.

Because of the loan processing changes required by the Act, the proposed language in section 1944.213(f)(3) regarding preapplications and applications was not adopted in this rule. One commentator expressed the opinion that the build and fill provisions should not apply if there was no similarity between the proposed units and existing units in type or kind, for example, family units versus elderly, 1- and 2-bedroom units versus 3- and 4-bedroom units. We considered this suggestion; however, regardless of type or size units, we believe it is necessary to assess the impact of newly developed units on the existing housing supply before authorizing additional units. For example, newly developed units may create vacancies in existing single or multi-family units that meet, or partially meet, the housing needs of the community. Therefore, no changes have been made to this policy.

3. Section 1944.215(n), establishing profit base on initial investment, has been revised to include provisions pertaining to low-income housing tax credit (LIHTC) syndication proceeds.

4. Section 1944.215(x) has been added to require the RHS servicing official to complete Form RD 2006-38, "Civil Rights Impact Analysis Certification," to

ensure compliance with the civil rights policy of the Rural Development mission area.

5. Section 1944.231. Several revisions were proposed to this section but have not been adopted in this rule because of the changes in loan processing procedures required by the Act.

6. Section 1944.233. Participation with other funding sources.

Ten comments were received on this section. No commentators opposed this section but several changes were recommended:

Three commentators felt we should not require a minimum amount of RHS participation. Two of these felt the Agency should be as flexible as possible and should determine the amount of the loan on a case by case basis; one felt it was in the "best interest of the government" for RHS to provide the minimum funds necessary.

We carefully weighed the pros and cons of establishing a minimum RHS funding level for participation loans. A major consideration is whether sufficient RHS rental assistance (RA) will be available for the large number of participation loans that could be developed without a minimum RHS funding level. Nevertheless, we want to encourage and participate in as many jointly-funded proposals as possible. Therefore, each state will be responsible for determining the amount of RHS loan funds and RA that can be provided for participation loans, based on the Agency's funding priorities, the state's funding and RA levels, and the amount of assistance needed to make the participation loan feasible. If RHS RA is to be provided, RHS loan participation must equal at least ten percent of the TDC unless an exception is granted to allow a lower percentage of participation by the Administrator or Deputy Administrator for Housing in accordance with §1944.240. No preference will be given to participation loans, and all loans must be processed in accordance with Agency regulations and funding priorities.

Two commentators noted that the proposed provisions regarding RA for participation loans in this section were inconsistent with existing Agency policy, which stipulates that, where all units require RA, the RHS loan must equal at least 50 percent of TDC; where all units do not require RA, the RHS loan must equal at least 25 percent and the RA provided will be commensurate with RHS' loan participation (for example, if RHS is providing 40 percent of the funds, no more than 40 percent of the units may receive RA). RA has been distributed this FY based on existing policy; however, beginning in

FY 1997, RA will be distributed in accordance with §1944.233, which provides that RHS RA can be provided on any unit where the debt service does not exceed what it would have been if RHS provided full financing, up to the RA limits established annually in RD Instruction 1940-L.

Several commentators felt that additional guidance was needed on security requirements for participation loans; one commentator offered suggestions for guidelines based on recent experience with jointly funded Community Facility projects. As a result, we have added additional guidance to this section.

We have added a paragraph designated "Design requirements," to ensure that complexes comply with the provisions of §1944.215 and §1944.222 and that any nonessential facilities permitted under this section are designed and operated with appropriate safeguards for tenant health and safety.

7. Exhibit A-7, section II.A. Addition of a requirement in Exhibit A-7 that the Market Study address need and demand for both family and elderly households and the applicant's loan proposal reflect the greater need.

Four commentators supported this requirement; three opposed it. Those who opposed this measure felt that the applicant should have a choice if there was a need for both types of housing. One commentator stated that demand will almost always be greater for families and that little, if any, elderly housing will be built if this requirement is implemented, leaving the elderly no choice but to live in family complexes although they often do not wish to do so.

After considering the arguments on both sides, we are adopting this measure with the following modifications: First, we believe the community should be aware of the results of the market analysis in all cases, including the analyst's recommendations regarding project type and size. We have revised exhibit A-7 to advise that the applicant will make available to the community the market study's conclusions regarding need and demand in the community and recommendations regarding number of units, type and number of bedrooms. This does not require the release of the market study in its entirety. Second, we have revised "greater need" to "greater proportionate need", that is, the share or percentage of the community's total rental units that are designated for the elderly will be compared to the community's share of elderly households, and the share of total rental units for families will be compared to the share of family

households in the community. Third, the applicant's proposed complex type must reflect the greater *proportionate* need of the community. (For mixed complexes, the unit mix must reflect the proportionate need of family and elderly households.) In unusual circumstances, an exception may be granted to this requirement by the State Director if at least one of the following conditions is met: the community's housing plan indicates that the community's greater immediate need is for the complex type of the smaller proportionate need and the plan includes a specific proposal to address the housing needs of the other household type; the complex has the support of a public community forum represented by diverse interests; or the units are needed because of an emergency or hardship situation, for example, a loss of housing caused by a natural disaster. The circumstances for the exception must be clearly documented in the casefile.

8. Exhibit A-7, section II.G. Use of a market survey to establish market feasibility on a case-by-case basis for proposals of 12 or fewer units.

Three commentors supported this change; three opposed it. One commentor who supported the revision recommended that this authority be limited to loan requests meeting specific conditions or from small nonprofit applicants. Those who opposed this option believe a professional market study is needed in all cases; one commented that loan quality has improved since the Agency began requiring professional market studies.

Opinions were evenly split on this issue, with good arguments for both sides. Because this change is optional for each State and requires a decision on a case-by-case basis under specific conditions, we have implemented this provision.

9. Implementation of a preliminary preapplication stage including a preliminary market analysis, or a preliminary market analysis only (with an otherwise full preapplication).

Three commentors favored implementing both a preliminary preapplication stage and market analysis; one commentor favored a preliminary market analysis only; two opposed either option; two commentors did not give an opinion (one wanted more information and felt little was saved from the existing process, the other stated that if a preliminary market analysis is implemented, a site visit should be required). The arguments for continuing to require a full preapplication and market analysis were compelling: (1) As much information, if not more, is required to reject a proposal

as to authorize it; if rejected, it would be very difficult to defend the Agency's decision based on preliminary information only; (2) Since two Agency reviews would be required (preliminary and full), the processing time would not be shortened; and (3) If a full market study is requested at a later time, it implies a decision has been made and it would be more difficult than ever to reject based on market feasibility.

Because of the valid concerns of those opposing this change and because there is no appreciable time savings, we are not implementing either option at this time. In addition, with the low volume of new loan requests because of reduced funding levels and the backlog of approved proposals, implementation of a simplified application process would not result in significant savings to either the public or RHS.

#### List of Subjects in 7 CFR Part 1944

Administrative practice and procedure, Aged, Handicapped, Loan programs—housing and community development, Low and moderate income housing, Mortgages, Nonprofit organizations, Rent subsidies, Rural areas.

Therefore, chapter XVIII, title 7, Code of Federal Regulations is amended as follows:

#### PART 1944—HOUSING

1. The authority citation for part 1944 continues to read as follows:

**Authority:** 5 U.S.C. 301; 42 U.S.C. 1480.

#### Subpart E—Rural Rental and Rural Cooperative Housing Loan Policies, Procedures, and Authorizations

2. Section 1944.211 is amended by revising the introductory text of paragraph (a)(2) and adding paragraph (a)(15) to read as follows:

##### § 1944.211 Eligibility requirements.

(a) \* \* \*

(2) Be unable to obtain the necessary credit from private or cooperative sources on terms and conditions that allow establishment of rent or occupancy charges within the payment ability of eligible tenants or members.

\* \* \* \* \*

(15) Meet the following requirements if the applicant, including the principals, has prior or existing RHS debts and is applying for a new or subsequent loan or requesting incentives to preclude prepayment. Applicants who do not meet these requirements will be rejected for failure to meet the applicable provisions of this section, as well as § 1965.213(c)(2)(i) of

subpart E of part 1965 of this chapter, if applicable.

(i) The applicant, including the principals, must be in compliance with existing debts in accordance with all legal and regulatory requirements and agreements, including the Promissory Note, Loan Agreement, and mortgage, all applicable local, state, and federal laws, and must provide regular financial and other required reports within required timeframes; or, if the applicant fails to meet any of these requirements, has an approved workout plan in effect that meets the provisions of paragraph (a)(15)(ii) of this section.

(ii) An applicant or principal with an approved workout plan in effect to correct deficiencies in an existing RHS debt may be considered for eligibility if the applicant or principal has been in compliance with the provisions of the workout plan for 6 months. The State Director may waive this requirement for borrowers who have acted in good faith but are in noncompliance through circumstances beyond their control, including substantial local economic downturn, natural disaster, assuming responsibility for a troubled loan through substitution of the general partners, or assuming a loan with an existing workout plan.

(iii) Applicants and principals must be in compliance with the provisions of the Civil Rights Act of 1964 (in accordance with their Form RD 400-4, "Assurance Agreement") and all other civil rights laws. If the Agency has reasonable grounds, based on a substantiated complaint, the Agency's own investigation, or otherwise, to believe that the representations of an applicant or borrower as to civil rights compliance are in some material respect untrue or are not being honored, assistance may be deferred or denied.

(iv) Applicants or principals who have been debarred but whose debarment period has expired will be considered for eligibility subject to all requirements of this section.

(v) Applicants, including principals, who have been determined ineligible by one state may not be determined eligible by another State until the problems have been corrected or workout plans are in effect in all States in which the applicant or principal is operating.

\* \* \* \* \*

##### § 1944.212 [Amended]

3. Section 1944.212 is amended by adding the words "purchase and" after the word "such" in the introductory text of paragraph (b).

4. Section 1944.215 is amended by revising paragraphs (n)(1) and (n)(2) and adding paragraph (x) to read as follows:

**§ 1944.215 Special conditions.**

\* \* \* \*

(n) \* \* \*

(1) Cash contributions made by the applicant from the applicant's own resources, which, when added to the loan and grant amounts from all sources, do not exceed the security value of the project. Proceeds received by the applicant from the syndication of low-income housing tax credits (LIHTC) and contributed to the project may be considered funds from the applicant's own resources for the portion of the proceeds which exceeds:

(i) the allowable developer's fee determined by the State Agency administering the LIHTC, and

(ii) the amounts expected to be contributed to the transaction, as determined by the State Agency administering the LIHTC.

(2) The value of the building site or essential related facilities contributed by the applicant up to the amount which, when added to the loan and grant amounts from all sources, is not in excess of the security value of the project. An appraisal will be completed in accordance with applicable RHS regulations. Value of the applicant's contribution will be determined on an "as is" basis less liens against the property.

\* \* \* \*

(x) *Civil Rights Impact Analysis.* It is the policy within the Rural Development mission area to ensure that the consequences of any proposed project approval do not negatively or disproportionately affect program beneficiaries by virtue of race, color, sex, national origin, religion, age, disability, or marital or familial status. To ensure compliance with these objectives, the RHS approval official will complete Form RD 2006-38, "Civil Rights Impact Analysis Certification."

5. Section 1944.221 is amended by revising the introductory text of paragraph (a) to read as follows:

**§ 1944.221 Security.**

(a) *Mortgage.* Each loan will be secured in a manner that adequately protects the financial interest of the Government. A first mortgage will be taken on the property purchased or improved with the loan, except as indicated in paragraphs (a)(1) and (a)(3) of this section and, for projects that are funded jointly by RHS and other sources, as indicated in § 1944.233(f).

\* \* \* \*

6. Section 1944.233 is added to read as follows:

**§ 1944.233 Participation with other funding sources.**

In order to develop the maximum number of affordable housing units and promote partnerships with states, local communities, and other partners with similar housing goals, RHS participation loans are encouraged.

Apartment complexes developed with participation funds may serve lower income households exclusively (RHS very-low and low income-eligible households; LIHTC income-eligible households) or may be marketed to households with mixed incomes. The following will apply:

(a) *RHS loan and rental assistance (RA) participation.*

(1) RHS may participate with loan funds only, or with both RA and loan funds, as provided in paragraphs (a)(2) and (a)(3) of this section.

(2) If RHS RA is being provided, RHS loan participation should equal at least ten percent of the project's total development cost unless authorization for a lower percentage of participation is obtained from the National Office in accordance with § 1944.240.

(3) RHS RA may be provided on any unit where the debt service does not exceed what the debt service would have been on that unit if RHS provided full financing. The number of RHS RA units available for participation loans is limited and established annually through subpart L of part 1940 of this chapter.

(b) *General conditions.*

(1) The number of units that will serve RHS income-eligible tenants must equal or exceed the number of units financed by RHS, determined by dividing the RHS loan amount by the State's average new construction cost.

(2) The total funds provided by all sources may not exceed what is necessary to make the project feasible in accordance with § 1944.213(a).

(3) The total debt from all sources is limited to the State Director's loan approval authority unless written authorization is obtained from the National Office in accordance with § 1944.213(b).

(4) The complex will be operated and managed in compliance with RHS requirements and regulations.

(5) If Low Income Housing Tax Credits are anticipated on a proportion of units higher than the percentage receiving RA or similar tenant subsidy, the market study must clearly reflect a need and market for units without deep subsidy. It is not the intent of RHS to provide servicing RA in the future nor can RHS provide RA on units which have a debt service higher than those if RHS had provided full financing.

(c) *Design requirements.* Complexes must comply with the provisions of §§ 1944.215 and 1944.222.

(1) Design features such as patios or balconies, washers and dryers, and garbage disposals may be included if they are customary for the area and needed for marketability.

(2) Mixed income complexes may include nonessential common facilities such as swimming pools provided:

(i) The facility is not financed with RHS funds,

(ii) The complex is able to support the facility's operating and maintenance costs through collection of a user fee from tenants who subscribe to the service, and

(iii) The facility is designed and operated with appropriate safeguards for tenant health and safety.

(d) *Borrower contribution and return on investment.*

(1) The minimum required borrower contribution will be based on the RHS loan amount and determined in accordance with § 1944.213(b).

(2) For limited profit borrowers, additional funds exceeding the minimum required contribution that are provided from the borrower's own resources (not loans or grants from other sources) may be included in the borrower's initial investment, for purposes of determining return on investment, as provided in § 1944.215(n).

(3) A loan from the borrower to the project may be considered, provided the loan proposal meets all conditions of this section and the loan to the project is from the borrower's own resources. LIHTC proceeds may be considered the borrower's own resources as provided in § 1944.215(n)(1).

(e) *Reserve requirements.* RHS reserve requirements (the annual reserve requirement and the fully funded reserve amount) will be determined on a case-by-case basis, taking into consideration the reserve requirements of the other participating lenders, so that the aggregate fully funded reserve amount established by RHS and the other lenders equals at least 10 percent of the project's total development cost (TDC) or appraised value, whichever is greater. For example, if the other lenders do not have reserve requirements, RHS will establish its reserve requirements to meet the full aggregate amount (at least 10 percent of the TDC or appraised value of the project, whichever is greater), regardless of the RHS loan amount. On the other hand, if the other lenders have aggregate reserve requirements equal to or higher than the minimum 10 percent of TDC or appraised value required by RHS, and

the amount is sufficient to meet project needs based on its capital improvement plan, it may not be necessary for RHS to establish additional reserve requirements. Reserve requirements and procedures for reserve withdrawals should be agreed upon by all lenders and included in the intercreditor or participation agreement referenced in paragraph (g) of this section.

(f) *Security requirements.*

(1) RHS will take a first or parity lien in all instances where the Agency's participation is 50 percent or more.

(2) If RHS participation is less than 50 percent, every effort should be made to obtain a parity lien position. If a parity lien cannot be negotiated, an exception may be requested to accept a second lien position in accordance with §1944.240. The State Director will submit requests to accept a second lien position to the Deputy Administrator, Multi-Family Housing with comments and recommendations.

(3) RHS will take a first lien on project revenue from rent or occupancy payments; RHS, State, or private RA payments; and operating and reserve accounts.

(g) *Participation agreement.* RHS will enter into a participation (or intercreditor) agreement with the other lenders that clearly defines each party's relationship and responsibilities to the others.

7. Section 1944.234 is added to read as follows:

**§1944.234 Actions prior to loan approval.**

Prior to loan approval the application will be reviewed for continued eligibility. The applicant may be required to submit updated information at that time.

8. Exhibit A-7 of subpart E is amended in paragraph I.H. by revising the words "preapplication package" to read "loan request"; and by revising paragraph I.E. and section II; and by adding a new paragraph III.D. to read as follows:

**EXHIBITS TO SUBPART E**

\* \* \* \* \*

**Exhibit A-7—Information To Be Submitted With a Loan Request For a Rural Rental Housing (RRH) or a Rural Cooperative Housing (RCH) Loan**

\* \* \* \* \*

**I. \* \* \***

E. Evidence Concerning the Test for Other Credit—Applicants must be unable to obtain other credit at rates and terms that will allow a unit rent or occupancy charge within the payment ability of the occupants. Based upon a review of the applicant's financial condition, the servicing official may require

the applicant to provide documentation regarding the availability of other credit.

\* \* \* \* \*

**II. Need and demand.**

A. Economic justification, the number of units, and the type of facility (family, elderly, congregate, mixed, group home, or cooperative) will be based on the housing need and demand of eligible prospective tenants or members who are permanent residents of the community and its surrounding trade area. Since the intent of the program is to provide housing for the eligible permanent residents of the community, temporary residents of a community (such as college students in a college town, military personnel stationed at a military installation within the trade area, or others not claiming their current residence as their legal domicile) may not be included in determining need and project size. Similarly, homeowners may not be included in determining need and project size. The market study must include a discussion of the current market for single family houses and how sales, or the lack of sales, will affect the demand for elderly rental units. The market study may discuss how elderly homeowners may reinforce the need for rental housing, but only as a secondary market and not as the primary market. The market study must assess need and demand for both family and elderly renter households. The conclusions of the market study must be provided to the community by the applicant, through direct contact with community officials whenever possible. The type of complex (family, elderly, etc.) that is proposed by the applicant must reflect the greater proportionate need and demand of the community, that is, the share or percentage of the community's total rental units that are designated for the elderly will be compared to the community's share of elderly households, and the share of total rental units for families will be compared to the share of family households in the community. (For mixed complexes, the unit mix must reflect the proportionate need of each household type.) In unusual circumstances, where there is a compelling need for a complex type that does not represent the greater proportionate need (i.e., family vs. elderly need), the State Director may consider granting an exception to this requirement. At least one of the following conditions must be met in order to consider an exception: the community's or State's housing plan indicates that the greater immediate need is for the complex type of the smaller proportionate need and the plan includes a specific proposal to address the housing needs of the other household type; the complex has the support of a public community forum represented by diverse interests; or the units are needed due to an emergency or hardship situation, for example, a loss of housing caused by a natural disaster. The circumstances for the exception must be documented in the casefile. The bedroom mix of the proposed units must reflect the need in the market area based on renter household size and the bedroom mix of existing units. Market feasibility for the proposed units will be determined by RHS based on the market

information provided by the applicant (requirements are described in section II.E. of this exhibit), RHS' knowledge of the market area and judgment concerning the need for new units, RHS' experience with the housing market in the State and local area, and the U.S. Department of Housing and Urban Development's (HUD's) or similar lender's analysis of market feasibility for the proposed units.

B. The applicant must provide a schedule of the proposed rental or occupancy rates and, for congregate housing proposals, a separate schedule listing the proposed cost of any nonshelter service to be provided.

C. For proposals where the applicant is requesting Low-Income Housing Tax Credits (LIHTC), the applicant must provide the number of LIHTC units and the maximum LIHTC incomes and rents by unit size. This information will determine the levels of incomes in the market area which will support the basic rents while also qualifying the borrower for tax credits.

D. For Rural Cooperative Housing (RCH) proposals, market feasibility will be evidenced by the names and addresses of prospective members who have definitely affirmed their intention of becoming cooperative members in the proposed project. In the event some persons cannot be accepted for membership for financial or other reasons, the cooperative should obtain more names than the number of proposed units in order to assure adequate feasibility coverage. Exhibit A-4 of this subpart contains a Cooperative Housing Survey form which may be used for this purpose.

E. For Rural Rental Housing (RRH) proposals, except as permitted by section II. G. of this exhibit, a professional market study is required. The qualifications of the person preparing the market study should include some housing or demographic experience. The following requirements apply:

(1) A table of contents, the analyst's statement of qualifications, and a certification of the accuracy of the study must be included.

(2) Market analysts must affirm that they will receive no fees which are contingent upon approval of the project by RHS, before or after the fact, and that they will have no interest in the housing project. An analyst with an identity of interest with the developer will need to fully disclose the nature of the identity.

(3) The analyst must personally visit the market area and project site and must certify to same in the market study. Failure to do so may result in the denial of further participation by the analyst in the Section 515 program.

(4) A detailed study based upon data obtained from census reports, state or county data centers, individual employers, industrial directories, and other sources of local economic and housing information such as newspapers, realtors, apartment owners and managers, community groups, and chambers of commerce is required. Exhibit A-8 of this subpart details the specific information which professional market studies are required to provide. The study must be presented in clear, understandable language. Negative as well as positive market trends

must be disclosed and discussed. Statistical data must be accompanied by analytical text which explains the data and its significance to the proposed housing. Mathematical calculations must be expressed in actual numbers and may be accompanied by percentages. Each table or section must identify the source of the data. A brief statement of the methodology used in the study should be included in the foreword and in other sections where necessary for clarity. RHS personnel will utilize the market study checklist found at exhibit A-12 of this subpart (available in any Rural Development office) as a means of measuring market study credibility.

(5) The market study will include:

a. A complete description of the proposed site and its location with respect to city boundary lines, residential developments, employment centers, and transportation; the location and description of available services and facilities and their distances from the site; a discussion of the site's desirability and marketability based on its location in the community, adjacent land uses, traffic conditions, air or noise pollution, and the location of competitive housing units; and a description of the site in terms of its size, accessibility, and terrain.

b. Pertinent employment data, including the name and location of each major employer within the community and market area, its product or service, number of employees and salary range, commute times and distances, and the year the employer was established at the location. If income data

cannot be obtained from individual employers, salary information for the community can be obtained from the state employment commission.

c. Population data required by exhibit A-8 of this subpart, including population figures by year, number and percentage of increase or decrease, and population characteristics by age.

d. Household data required by exhibit A-8 of this subpart, including number of households by year, tenure (owner or renter), age, income groups, and number of persons per household.

e. Building permits issued and demolitions by year by single unit dwelling and multiple unit dwelling. In nonreporting jurisdictions, this information may be substituted with the number of requests for electric service connections, number of water or sewer hookups, etc., obtained from local suppliers.

f. Housing stock by tenure and vacancy rates for total number of units, one-unit buildings, two- or more-unit buildings, mobile homes, and number lacking some or all plumbing facilities.

g. A survey of existing rental housing by name, location, year built, number of units, amenities, bedroom mix, type (family, elderly, etc.), rental rates, and rental subsidies if any.

h. A projection of housing need and demand and the analyst's recommendation for the number, type, and size of units, based on the number of RHS and LIHTC income-eligible renter households, the existing comparable housing supply and vacancy

rates, the absorption rate of recently completed units, the number of comparable units currently proposed or under construction, and current and projected economic conditions.

F. For congregate housing proposals with central dining area or housing involving a group living arrangement, a narrative statement from local, state, or federal government agencies supporting the current and long-range need for the facilities in the community and its trade area is required.

G. For RRH proposals of 12 or fewer units, the State Director may authorize the use of a market survey to establish market feasibility on a case-by-case basis. This authority may be used when there is evidence of strong market demand, for example, very low vacancy rates and long waiting lists in existing assisted or comparable rental units. The casefile must be documented accordingly. Exhibits A-2, A-3, and A-5 of this subpart may be used for the market survey.

III. \* \* \*

D. Appropriate zoning or evidence of capability to be appropriately zoned.

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Dated: May 1, 1997.

**Jill Long Thompson,**

*Under Secretary, Rural Development.*

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