

# DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

## 24 CFR Part 811

[Docket No. FR-3985-F-01]

RIN: 2502-AG64

### Office of the Assistant Secretary for Housing—Federal Housing Commissioner; Regulatory Reinvention; Tax Exemption of Obligations of Public Housing Agencies and Related Amendments

**AGENCY:** Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

**ACTION:** Final rule.

**SUMMARY:** This final rule amends HUD's regulations governing the tax exemption of obligations of public housing agencies. In an effort to implement the President's regulatory reform initiative, this rule will streamline these regulations by eliminating provisions that are redundant of statutes or otherwise unnecessary. Further, on April 20, 1995 (60 FR 19695), HUD published a rule proposing to amend these regulations to codify the guidelines which have governed Section 8 bond refundings. This rule finalizes the policies and procedures set forth in the April 20, 1995 proposed rule, and discusses the issues raised by public comments submitted on the proposed rule. The rule also makes a clarifying amendment to the existing regulations.

**EFFECTIVE DATE:** May 1, 1996.

**FOR FURTHER INFORMATION CONTACT:** James Mitchell, Director, Financial Services Division, Department of Housing and Urban Development, 470 L'Enfant Plaza East, room 3120, Washington, DC 20024, telephone number (202) 708-7450, ext. 125 (this is not a toll-free number). For hearing- and speech-impaired persons, this number may be accessed via TDD by calling the Federal Information Relay Service at 1-800-877-8339.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

##### A. Part 811 and the President's Regulatory Reinvention Initiative

On March 4, 1995, President Clinton issued a memorandum to all Federal departments and agencies regarding regulatory reinvention. In response to this memorandum, the Department of Housing and Urban Development conducted a page-by-page review of its regulations to determine which can be eliminated, consolidated, or otherwise improved. As part of this review, HUD

examined its regulations at 24 CFR part 811, which govern the tax exemption of obligations of public housing agencies. HUD has determined that 24 CFR part 811 can be improved and streamlined by eliminating unnecessary provisions.

Several provisions in part 811 repeat statutory language from the United States Housing Act of 1937 (42 U.S.C. 1437 *et seq.*). It is unnecessary to repeat statutory requirements in the Code of Federal Regulations, since these requirements are otherwise fully accessible and binding. Furthermore, regulatory provisions which reiterate statutory language, must be amended each time Congress amends the statute. Therefore, this final rule removes redundant statutory language and replaces it with a citation to the specific statutory section.

Some provisions in part 811 are now obsolete. For instance, this rule removes obsolete provisions that were designed for the original construction or substantial rehabilitation of subsidized Section 8 rental housing. Further, the program described in subpart B of part 811, concerning the purchase of GNMA guaranteed mortgage-backed securities with tax exempt obligations, has never been implemented by HUD. Accordingly, this final rule removes subpart B.

Lastly, some provisions in part 811 are not regulatory requirements. For example, several sections in the regulations contain nonbinding guidance or explanations. While this information is very helpful to HUD's clients, HUD will more appropriately provide this information through handbook guidance or other materials rather than maintain it in title 24 of the Code of Federal Regulations.

##### B. The April 20, 1995 Proposed Rule

##### 1. Proposed Amendments Made by the April 20, 1995 Rule

On April 20, 1995 (60 FR 19695), HUD published for public comment a rule proposing to amend 24 CFR part 811 to codify the guidelines that have governed Section 8 bond refundings.

HUD's regulations at 24 CFR part 811, subpart A govern HUD's issuance of a Notification of Tax Exemption. These regulations were designed for the original construction or substantial rehabilitation of subsidized Section 8 rental housing. Refunding transactions not involving construction funding have required the Assistant Secretary for Housing-FHA Commissioner to issue a Notification of Tax Exemption that waives several sections of 24 CFR part 811, subpart A. This waiver process elevates to the Assistant Secretary level

a programmatic approval that has become routine and perfunctory in recent years.

The April 20, 1995 rule proposed to create a new § 811.119,<sup>1</sup> which would codify the policy and procedural guidelines that have governed Section 8 bond refundings since 1989. The new section would provide a self-contained refunding regulation that would dispense with the need for most waivers. The preamble to the April 20, 1995 proposed rule described in detail the amendments to 24 CFR part 811, subpart A.

##### 2. Discussion of Public Comments on the April 20, 1995 Proposed Rule

The public comment period on the proposed rule expired on June 19, 1995. By close of business on that date, a total of 6 comments had been received. The following section of the preamble presents a summary of the significant issues raised by the public commenters on the proposed rule, and HUD's responses to these comments.

##### *Proposed § 811.119(g) Exceeded HUD Authority*

*Comment.* Paragraph (g) of proposed § 811.119 stated that "HUD will consent to release reserves, as provided by the Trust Indenture, in an amount remaining after correction of project physical deficiencies and/or replenishment of replacement reserves \* \* \* upon execution by the project owner of a use agreement, and amendment of a regulatory agreement, if applicable, to extend low-income tenant occupancy for ten years after expiration of the HAPC." Four of the commenters believed that this provision exceeded HUD's authority.

The commenters noted that the provisions of proposed paragraph (g) were not included in the "old reg" version of 24 CFR part 811, which was effective from September, 1977 until March, 1979. These commenters believed that to the extent paragraph (g) purported to apply to transactions financed under the "old regs", HUD would be violating the contractual rights of participants in those transactions. The commenters noted that there appears to be no legal basis for the requirement that HUD approve the

<sup>1</sup> As a result of the streamlining amendments made in compliance with President Clinton's regulatory reform initiative, several sections in part 811 have been renumbered. This rule finalizes proposed § 811.119 at § 811.110. Substantively, § 811.110 is identical to proposed § 811.119, except where changes have been made in response to public comment. The preamble to this final rule contains a discussion of the public comments received on the April 20, 1995 proposed rule, and HUD's responses to them.

release of reserves from trust indentures that are being refunded, defeased or prepaid. In most "old reg" transactions those reserves belong to the project owners upon defeasance of the prior bonds. The commenters believed that HUD's attempt to condition the release of the owner's money upon the owner's entrance into a use agreement raised serious legal and constitutional issues.

**HUD Response.** HUD interprets the prohibition of refundings described in § 811.106(d) of the "old regs" to apply to refundings of outstanding section 11(b) bonds by any means, not only by a new section 11(b) bond issue. Therefore, a waiver of "old reg" § 811.106(d) is required to refund "old reg" bonds. The waiver of a regulatory provision is more than a perfunctory function, since HUD must first determine that the public will benefit by the waiver.

HUD does not dispute that project owners or PHAs are entitled to reserve balances as provided in "old reg" indentures. However, HUD considers it sensible to review the condition of the project and its future as low-income housing before these usually large sources of funds are used for purposes unrelated to the project. Further, it is not unreasonable for PHAs to extend low-income occupancy for a period of ten years in return for use of the released reserves.

HUD also notes that many "old reg" indentures specifically require that HUD consent to the refunding of the bonds. The "old regs" at § 811.107(d) provide that excess reserves shall be used for project purposes. HUD has waived this requirement to accommodate refundings which use reserves for other purposes, provided that HUD found no need for physical repairs. However, HUD believes it is reasonable to give the project first consideration.

The final rule has been revised to increase flexibility in the case of privately owned projects. Specifically, the final rule provides that the use extension may be waived on the basis of some other public benefit, such as transfer of ownership to a nonprofit entity, or correction of project physical or operating deficiencies. This exercise of HUD waiver authority to secure a sound resource of low-income housing will benefit HUD, PHAs, owners, and project residents.

This final rule also clarifies that in those instances involving a simple defeasance without pay-off of "old reg" section 11(b) bonds, HUD will review the financing terms only to the extent that a HUD approval is needed in the transaction.

#### *Proposed Rule's Relation to 24 CFR Part 883 Unclear*

**Comment.** Three commenters wondered whether the proposed rule applied to bonds issued by approved state housing finance agencies pursuant to 24 CFR part 883. One of the commenters wrote that the April 20, 1995 proposed rule was contradictory on the issue of its applicability to part 883. The preamble to the proposed rule stated that the rule applied only to refundings of bonds exempt under Section 11(b). However, the commenter noted that proposed § 811.119 contained at least one reference to part 883 in paragraph (c), and paragraphs (f) and (h) appeared to address all McKinney Act refundings of Section 8 projects regardless of the source of the tax-exemption.

Another commenter was particularly concerned about paragraph (c) of proposed § 811.119. The first sentence of paragraph (c) stated that "[c]ompliance with §§ 811.104 and 811.105 shall not be required for refunding obligations which derive tax exemption from authority other than Section 11(b) of the [United States Housing Act of 1937]." The commenter believed that by stating that non-11(b) bonds need not comply with §§ 811.104 and 811.105, it could be argued that bonds issued pursuant to part 883 must comply with all other provisions of part 811.

The commenter also worried about the second sentence of paragraph (c), which stated that "compliance with the provisions of 24 CFR part 883 shall be required to the extent bond counsel finds such provisions applicable." The commenter believed that this sentence could be interpreted to permit bond counsel, in part 883 refundings of part 883 bonds, to select those provisions of part 883 it thought applicable, and ignore the rest of the regulatory provisions.

The commenter suggested that paragraph (c) of proposed § 811.119 be revised to state that it does not apply to bonds issued by State Agencies under 24 CFR part 883 and which derive tax exemption from authority other than Section 11(b) of the United States Housing Act of 1937.

**HUD Response.** HUD has clarified the final rule to explicitly limit its applicability to State Agency Section 8 bond issues to: (1) Reiteration of the prohibition of duplicate fees in part 883; and (2) in the case of McKinney Act refundings, compliance with paragraphs (f) and (h) of § 811.110. Further, in response to the second commenter, HUD has amended the rule to clarify

that its requirements apply only to refunding bonds issued pursuant to § 811.110. This final rule also removes the first two sentences of paragraph (c) of proposed § 811.119.

#### *Proposed Rule's Relationship to Internal Revenue Code Unclear*

**Comment.** The first sentence of proposed § 811.119(c) stated that "[c]ompliance with §§ 811.104 and 811.105 shall not be required for refunding obligations which derive tax exemption from authority other than Section 11(b)." Proposed § 811.119(i) stated that "[r]efunding bonds, including interest thereon, approved under proposed § 811.119 shall be exempt from all taxation now or hereafter imposed by the United States." Two commenters pointed out that since 1982 all tax exempt bonds, including section 11(b) bonds, must comply with the Internal Revenue Code. Compliance with 24 CFR part 811 alone is no longer sufficient for tax-exemption.

The commenters believed that paragraphs (c) and (i) could easily be read to suggest that only compliance with 24 CFR part 811 is necessary for tax exemption. The commenters suggested that the final rule explicitly state that compliance with part 811 does not eliminate the need to comply with the Internal Revenue Code.

**HUD Response.** HUD agrees with the commenters that the proposed rule required clarification on the relationship between part 811 and the Internal Revenue Code. Accordingly, the final rule has been revised to provide that compliance with the requirements of 24 CFR part 811 does not assure compliance with the relevant provisions of the Internal Revenue Code.

#### *Paragraph (h) of Proposed § 811.119 Was Too Limiting*

**Comment.** The first sentence of paragraph (h) of proposed § 811.119 stated that "[a]gencies shall have wide latitude in the design of specific delivery vehicles for use of McKinney Act savings." Paragraph (h) went on to set forth a list of eligible activities for which savings "shall" be utilized. Three commenters believed that the remainder of paragraph (h) contradicted the flexibility promised in the first sentence. Furthermore, the commenters believed that paragraph (h) was more restrictive than current HUD practice.

The commenters suggested similar remedies for the perceived strictness of paragraph (h). One of the commenters suggested that the word "shall" in the second sentence of paragraph (h) be replaced with the word "may." The commenter also recommended that

HUD include at the end of the sentence an additional phrase permitting "other activities approved by HUD." Another of the commenters recommended that HUD add a new third sentence to the following effect: "These include programs designed to assist in obtaining shelter such as rent subsidy and similar tenant based programs."

**HUD Response.** HUD agrees with the commenters and has adopted all their suggestions in this final rule.

#### *Rule Should Reference "Trustee Sweeps"*

**Comment.** Paragraph (d) of proposed § 811.119 stated that the Assistant Secretary's approval of the Notification of Tax Exemption would be based on the conformity of the "refunding's terms and conditions \* \* \* to subpart A's requirements, including[,] \* \* \* where possible, reduction of Section 8 assistance payments through lower contract rents or equivalent means." One of the commenters wondered whether paragraph (d) covered a subsidy recapture method known as the "Trustee Sweep." According to the commenter most of the FHA-Insured Section 8 refundings that have occurred have used this method.

**HUD Response.** This final rule clarifies that the "Trustee Sweep" is a permissible subsidy recapture method.

#### *Proposed Rule Failed To Take Underwriters Into Account*

**Comment.** Paragraph (e)(1) of proposed § 811.119 stated that HUD's evaluation of the Section 8 refunding proposal "shall determine that the proposed amount of refunding obligations is the amount needed to \* \* \* fund a debt service reserve to the extent required by bond rating agencies which rate the credit quality of the refunding bonds." Two commenters believed that paragraph (e)(1) of proposed § 811.119 failed to cover certain financings. The commenters wrote that in financings closed on a non-rated basis, the underwriter, as opposed to the Rating Agency, will often require a debt service reserve fund based upon its determination of investor requirements. The commenters suggested that the final rule allow for the sizing of the debt service reserve in this manner.

**HUD Response.** This final rule adopts the recommendation made by the commenters and recognizes that debt service reserves may also be required by credit enhancers and, for unrated bonds, by the underwriter.

#### *Repayment Term Limit Requires Change*

**Comment.** Two commenters expressed concern over paragraph (e)(2) of proposed § 811.119, which prohibited the repayment term of the refunding bonds from exceeding the remaining term of the project's mortgage, or in the absence of a mortgage, the HAP Contract. One of the commenters wrote that the proposed paragraph was insufficiently broad. This commenter pointed out that in MBIA transactions the insurer requires that the maturity of the bonds extend a year beyond the mortgage maturity. The bonds are redeemed concurrently with mortgage maturity but the stated maturity is longer.

The commenter also believed that paragraph (e)(2) would create unnecessary difficulties for some agencies seeking to refinance. The commenter noted that in the original 11(b) financings, the transactions had to be structured based on an estimate of when the project was to be completed. Based on that estimate, the expiration of the HAP contract was derived. This expiration date became the basis for the maturity of the bonds, since the HAP contract was the primary security for the bonds. However, in some financings, the project was completed sooner than anticipated and, therefore, the HAP contract was executed earlier than estimated. In those instances the HAP contract could expire sometime before the maturity date of the bonds.

The commenter felt that by requiring that refunding bonds mature at a date not exceeding the expiration of the HAP contract, the rule would produce structuring problems as a result of the term of the refunding bonds being forced to be shorter than the term of the bonds they are refunding. However, the commenter noted that if the HAP contract term is later than the original bond term, it might be advantageous to have a bond term that takes full advantage of the HAP contract term. The commenter suggested that HUD allow the term of the bonds on uninsured loan transactions to extend to the later of the expiration of the HAP contract or the final maturity of the refunded bonds.

Another commenter believed paragraph (e)(2) of proposed § 811.119 posed compliance difficulties for agencies seeking to refinance projects at lower interest rates. The commenter noted that in order to comply with rating agency structuring criteria relating to debt service reserve funds in transactions where there is an insured mortgage loan, the bonds often are structured to mature between 6 months and one year after the last required

mortgage payment. This is necessary because mortgage loans with grace periods are assumed by rating agencies and bond underwriters to be received at the end of the grace period. A second reason for this requirement is the potential that a mortgage loan might be in default at the time of its stated maturity, requiring an invasion of the debt service reserve fund pending disbursement of FHA mortgage insurance proceeds, which could be received after final due date of the last mortgage payment. Rating agencies typically require a structure in which up to one year is assumed to elapse between the date of default on the mortgage and the receipt of the final installment of FHA mortgage insurance proceeds. Accordingly, the commenter suggested that paragraph (e)(2) be amended to add the words "by more than one year" after the phrase "may not exceed."

**HUD Response.** HUD agrees with these comments and has incorporated them in the final rule.

#### *The Proposed Rule Created Uncertainty About the Continuation of Current HUD Practices*

**Comment.** One commenter believed that paragraph (f) of proposed § 811.119 created uncertainty among agencies seeking to refinance. This paragraph stated that for McKinney Act Projects, HUD would split the savings with an agency, in accordance with the terms of the Refunding Agreement. Paragraph (f) required that the Refunding Agreement incorporate the agency's Housing Plan. The paragraph further mandated that the Housing Plan provide for "decent, safe, and sanitary housing for very-low income households." Additionally, the Housing Plan was required to "address the physical condition of the projects participating in the refunding which generate[d] the McKinney Act savings and, if necessary, provide for the correction of existing deficiencies which [could] not be funded completely by existing project replacement reserves and/or by a portion of refunding bond proceeds."

The commenter believed that paragraph (f) was inconsistent with existing HUD policies. First, the commenter believed paragraph (f) contradicted a HUD memorandum concerning savings splits. Furthermore, the commenter wrote that HUD has approved the application of savings for uses other than those required by paragraph (b). For example, the commenter claimed that HUD has not required that savings be used to benefit a specific project. The commenter also wrote that savings currently need to be

used in connection with low-income households, as distinguished from very-low-income households.

**HUD Response.** HUD acknowledges that the proposed rule did not accurately reflect HUD's current policy regarding savings splits. Accordingly, this final rule corrects this discrepancy by providing that for McKinney Act refundings of projects which did not receive a Financing Adjustment Factor ("FAF"), HUD will allow up to 50 percent of debt service savings to be allocated to the project account. In such cases, the remainder of the debt service savings will be shared equally by the agency and the U.S. Treasury. However, the other assertions made by the commenter are incorrect. For example, section 1012(a) of the McKinney Act restricts assistance to "very low-income families." (42 U.S.C. 1437f note.)

#### *Revision of Bond Counsel Certification Requirement*

**Comment.** The last sentence of paragraph (d) of proposed § 811.119 stated that the results of a refunding bond sale had to "certified" by bond counsel. One commenter was disturbed by the use of the word "certified." The commenter wrote that bond counsel are not in a position to certify such matters, other than in reliance on information provided by other parties. Another commenter, while not objecting to the term "certify", noted that bond counsel are seldom financial experts. The commenter suggested that the rule be amended to permit certification by a bona fide financial expert, such as a certified public accountant or an investment banker.

**HUD Response.** HUD has adopted both comments. This final rule uses the term "written confirmation", rather than "certify." Further, it permits "other acceptable closing participants" to provide written confirmation.

#### *Flexible Yield Limitation Required*

**Comment.** Paragraph (e)(3) of proposed § 811.119 limited the bond yield to not more than 75 basis points above the 20 Bond General Obligation Index "published by the Daily Bond Buyer for the week immediately preceding the sale of the bonds." One commenter felt that this paragraph would place the continuation of current HUD practices in doubt, and might create the necessity for waivers.

The commenter noted that HUD has in the past waived the bond yield limitation for certain financings. Furthermore, HUD from time to time published notices which allowed a 150 basis point spread on uninsured deals. The commenter suggested that

paragraph (e)(3) be amended to add "except as otherwise approved by HUD", in order to eliminate the need for waivers.

**HUD Response.** In recognition of rating agency concerns about the future renewability of HAP contracts, HUD has revised the final rule to incorporate the phrase suggested by the commenter. However, HUD's experience has shown that the 20 Bond General Obligation Index plus 75 basis points provides a valid market sensitive yield limit for a variety of transactions.

#### *Paragraph (d) of Proposed § 811.119 Required Clarification*

**Comment.** One commenter raised several concerns over paragraph (d) of proposed § 811.119. This paragraph stated that "[u]pon conclusion of the sale of refunding bonds, the results must be certified to HUD by bond counsel, including a schedule of the specific amount of savings in Section 8 assistance where applicable, and a final statement of Sources and Uses."

The commenter pointed out that the term "sale" usually signifies the signing of a Bond Purchase Agreement, at which time it may be premature to provide the information requested by paragraph (d). This commenter suggested that the word "closing" be substituted for "sale." The commenter was also uncertain about the information HUD meant to include in the term "results."

**HUD Response.** HUD agrees with the points raised by the commenter. Accordingly, the final rule has been revised to use the term "closing", rather than "sale." Further, this final rule replaces the term "results" with a specific list of the closing information required by HUD.

#### *Paragraph (e) of Proposed § 811.119 Was Vague*

**Comment.** One of the commenters believed that paragraph (e) of proposed § 811.119 was vague. For example, paragraph (e)(2) prohibited the repayment term of the refunding bonds from exceeding the remaining term of the "project mortgage, or in the absence of a mortgage, the remaining term of the Housing Assistance Payments Contract (the 'HAPC')." The commenter wondered whether HUD meant an insured or uninsured mortgage. The commenter also believed that paragraph (e)(3) required further clarification on servicing and trustee fees. The proposed rule limited these fees to "[a]n amount not to exceed one-fourth of one percent annually of the bonds." The commenter felt it would be "advisable to allow for the calculation of fees to be based on the outstanding mortgage balance."

**HUD Response.** HUD has amended the final rule to provide the clarification requested by the commenter. The final rule clarifies that the term "project mortgage" refers to an insured mortgage. Further, the final rule specifies that the limit on servicing and trustee fees is based on the outstanding principal balance of the bonds.

#### *Definition of McKinney Act Project Was Vague*

Paragraph (f) of proposed § 811.119 concerned "projects placed under HAPC between January 1, 1979 and December 31, 1984 (otherwise known as 'McKinney Act Projects')." One commenter believed that HUD should clarify what constitutes a "McKinney Act Project." The commenter pointed out that HUD has construed this ambiguous statutory language to cover projects for which the date of HAPC execution fell within January 1, 1979 and December 31, 1984, as distinguished from the effective date of the HAPC, or conceivably the AHAP date. The commenter suggested that the final rule make this construction explicit.

**HUD Response.** HUD has adopted the recommendation made by the commenter. The final rule defines a "McKinney Act Project" as a project "for which the Agreement to enter into the HAPC was executed between January 1, 1979 and December 31, 1984."

#### *Paragraph (g) of Proposed § 811.119 Ambiguous in the Case of HAPCs With Renewable Five-Year Terms*

**Comment.** Paragraph (g) of proposed § 811.119 conditioned the release of reserves upon the project owner's agreement "to extend low income tenant occupancy for ten years after expiration of the HAPC." One commenter believed that this provision could be ambiguous in the case of a HAPC with renewable five-year terms. The commenter wondered whether paragraph (g) meant ten years after HUD's or the Contract Administrator's first right to terminate, ten years after the owner's first opt-out date without HUD consent, or ten years after the budget authority term.

**HUD Response.** HUD has revised the final rule to specify that the use agreement must extend for ten years past the owner's first opt-out date.

#### *Payments to Providers of Professional Services*

**Comment.** One of the commenters felt there was some ambiguity in the relationship between the last two sentences of paragraph (h) of proposed § 811.119. The penultimate sentence

authorized homeownership counseling as an eligible use of savings. However, the last sentence prohibited payments to third party consultants.

*HUD Response.* This final rule permits fees to providers of professional services required in an agency's McKinney Act program.

### C. Clarifying Amendment to § 811.105

This rule also makes a clarifying technical amendment to paragraph (b) of § 811.105. Under § 811.102, the term "Agency or Instrumentality PHA" is defined as an "organization that is authorized to engage or assist in the development or operation of low-income housing." However, paragraph (b) of § 811.105 requires that the "charter or other organic document establishing the [Agency or Instrumentality PHA] shall limit the activities to be performed \* \* \* to carrying out Section 8 projects."

Paragraph (b) of § 811.105 unnecessarily restricts the activities which may be undertaken by an Agency or Instrumentality PHA. This limitation does not conform to the broad language of the definition in § 811.102. Further, § 811.105 does not comply with HUD's goal of expanding low-income housing opportunities through the part 811 program regulations. The current language also requires that HUD waive § 811.105 each time an Agency or Instrumentality PHA seeks to undertake an activity which is not a Section 8 project. The imposition of this additional administrative barrier is contrary to the goals of the President's reinvention Initiative, which calls for the elimination of unnecessary bureaucratic delays.

This final rule amends paragraph (b) of § 811.105 to provide that Agency and Instrumentality PHAs may carry out Section 8 projects and "other low-income housing projects approved by the Secretary." This change will conform § 811.105 to HUD's original intention in the issuance of the part 811 regulations.

### II. Justification for Final Rulemaking

HUD generally publishes a rule for public comment before issuing a rule for effect, in accordance with its own regulations on rulemaking in 24 CFR part 10. However, part 10 provides for exceptions to the general rule if the agency finds good cause to omit advance notice and public participation. The good cause requirement is satisfied when prior public procedure is "impracticable, unnecessary, or contrary to the public interest" (24 CFR 10.1). HUD finds that in this case it is unnecessary to solicit public comment.

HUD has already solicited public comment for those amendments to part 811 described in the April 20, 1995 proposed rule. The preamble to this final rule contains a discussion of the comments received and of HUD's responses to them. The streamlining amendments made in conformity with the President's regulatory reinvention initiative do not affect or establish policy. These amendments merely remove regulatory provisions which are redundant of statutes or for which codification in the Code of Federal Regulations is unnecessary. Further, it is unnecessary for HUD to solicit comment on the clarifying amendment to § 811.105. This revision merely removes an administrative barrier which currently limits the flexibility of program applicants. The change will eliminate the necessity for waivers and will conform the regulations to HUD's original intent in issuing 24 CFR part 811.

### III. Other Matters

#### A. Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this final rule, and in so doing certifies that this rule will not have a significant economic impact on a substantial number of small entities. This rule merely streamlines regulations by removing unnecessary provisions. The rule will have no adverse or disproportionate economic impact on small businesses.

#### B. Environmental Impact

This rulemaking does not have an environmental impact. This rulemaking simply amends an existing regulation by consolidating and streamlining provisions and does not alter the environmental effect of the regulations being amended. A Finding of No Significant Impact with respect to the environment was made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332) at the time of development of regulations implementing the Tax Exempt Obligations Program. That finding remains applicable to this rule, and is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC.

#### C. Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, *Federalism*, has determined that this rule will not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. No programmatic or policy changes will result from this rule that would affect the relationship between the Federal Government and State and local governments.

#### D. Executive Order 12606, The Family

The General Counsel, as the Designated Official under Executive Order 12606, *The Family*, has determined that this rule will not have the potential for significant impact on family formation, maintenance, or general well-being, and thus is not subject to review under the Order. No significant change in existing HUD policies or programs will result from promulgation of this rule.

#### List of Subjects in 24 CFR Part 811

Public housing, Securities, Taxes.

Accordingly, 24 CFR part 811 is amended to read as follows:

### **PART 811—TAX EXEMPTION OF OBLIGATIONS OF PUBLIC HOUSING AGENCIES AND RELATED AMENDMENTS**

1. The authority citation for 24 CFR part 811 continues to read as follows:

Authority: 42 U.S.C. 1437, 1437a, 1437c, 1437f, and 3535(d).

#### **Subpart A—[Removed]**

2. The heading for subpart A is removed.

3. Section 811.101 is revised to read as follows:

#### **§ 811.101 Purpose and scope.**

(a) The purpose of this part is to provide a basis for determining tax exemption of obligations issued by public housing agencies pursuant to Section 11(b) of the United States Housing Act of 1937 (42 U.S.C. 1437i) to refund bonds for Section 8 new construction or substantial rehabilitation projects.

(b) This part does not apply to tax exemption pursuant to Section 11(b) for low-income housing projects developed pursuant to 24 CFR parts 950 and 941.

4. Section 811.102 is amended by:

a. Removing the paragraph designations;

b. Removing the definitions of “*Capitalized Interest During Construction*” and “*Development Cost*”; and

c. Revising the definition of “*Obligations*” to read as follows:

**§ 811.102 Definitions.**

\* \* \* \* \*

*Obligations.* Bonds or other evidence of indebtedness that are issued to provide permanent financing of a low-income housing project. Pursuant to Section 319(b) of the Housing and Community Development Act of 1974, the term obligation shall not include any obligation secured by a mortgage insured under Section 221(d)(3) of the National Housing Act (12 U.S.C. 1715l) and issued by a public agency as mortgagor in connection with the financing of a project assisted under Section 8 of the Act. This exclusion does not apply to a public agency as mortgagee.

\* \* \* \* \*

5. Section 811.105 is amended by revising the first sentence in paragraph (b) to read as follows:

**§ 811.105 Approval of agency or instrumentality PHA.**

\* \* \* \* \*

(b) The charter or other organic document establishing the applicant shall limit the activities to be performed by the applicant, and funds and assets connected therewith, to carrying out or assisting in carrying out Section 8 projects and other low-income housing projects approved by the Secretary. \*\*

\* \* \* \* \*

**§ 811.106 [Amended]**

6. Section 811.106 is amended by revising the section heading; by removing paragraphs (a), (b), and (c); and by removing the paragraph designation to paragraph (d), to read as follows:

**§ 811.106 Default under the contract.**

\* \* \* \* \*

7. Section 811.107 is revised to read as follows:

**§ 811.107 Financing documents and data.**

(a) The financing agency shall assure that any official statement or prospectus or other disclosure statement prepared in connection with the financing shall state on the first page that:

(1) In addition to any security cited in the statement, the bonds may be secured by a pledge of an Annual Contributions Contract and a Housing Assistance Payments Contract, executed by HUD;

(2) The faith of the United States is solemnly pledged to the payment of

annual contributions pursuant to the Annual Contributions Contract or to the payment of housing assistance payments pursuant to the Housing Assistance Payments Contract, and funds have been obligated by HUD for such payments;

(3) Except as provided in any contract of mortgage insurance, the bonds are not insured by HUD;

(4) The bonds are not to be construed as a debt or indebtedness of HUD or the United States, and payment of the bonds is not guaranteed by the United States;

(5) Nothing in the text of a disclosure statement is to be interpreted to conflict with the above; and

(6) HUD has not reviewed or approved and bears no responsibility for the content of disclosure statements.

(b) The financing agency shall retain in its files the documentation relating to the financing. A copy of this documentation shall be furnished to HUD upon request.

8. Section 811.108 is revised to read as follows:

**§ 811.108 Debt service reserve.**

(a) *FHA-Insured projects.* (1) The debt service reserve shall be invested and the income used to pay principal and interest on that portion of the obligations which is attributable to the funding of the debt service reserve. Any excess investment income shall be added to the debt service reserve. In the event such investment income is insufficient, surplus cash or residual receipts, to the extent approved by the field office, may be used to pay such principal and interest costs.

(2) The debt service reserve and its investment income shall be available only for the purpose of paying principal or interest on the obligations. The use of the debt service reserve for this purpose shall not be a cure for any failure by the owner to make required payments.

(3) Upon full payment of the principal and interest on the obligations (including that portion of the obligations attributable to the funding of the debt service reserve), any funds remaining in the debt service reserve shall be remitted to HUD.

(b) *Non-FHA-insured projects.* (1) Investment income from the debt service reserve, up to the amount required for debt service on the bonds attributable to the debt service reserve, shall be credited toward the owner's debt service payment. Any excess investment income shall be added to and become part of the debt service reserve.

(2) The debt service reserve and investment income thereon shall be available only for the purpose of paying

principal or interest on the obligations. The use of the debt service reserve for this purpose shall not be a cure for any failure by the owner to make required payments.

(3) Upon full payment of the principal and interest on the obligations (including that portion of the obligations attributable to the funding of the debt service reserve), any funds remaining in the debt service reserve shall be remitted to HUD.

**§§ 811.109 through 811.113 [Removed]**

9. Sections 811.109 through 811.113 are removed.

**§ 811.114 [Redesignated]**

10. Section 811.114 is redesignated as § 811.109 and newly redesignated § 811.109 is amended by removing paragraphs (a) through (c), and by removing the paragraph designation to paragraph (d).

**§§ 811.115 through 811.118 [Removed]**

11. Sections 811.115 through 811.118 are removed.

12. Section 811.110 is added to read as follows:

**§ 811.110 Refunding of obligations issued to finance Section 8 projects.**

(a) This section states the terms and conditions under which HUD will approve refunding or defeasance of certain outstanding debt obligations which financed new construction or substantial rehabilitation of Section 8 projects, including fully and partially assisted projects.

(b) In the case of bonds issued by State Agencies qualified under 24 CFR part 883 to refund bonds which financed projects assisted pursuant to 24 CFR part 883, HUD requires compliance with the prohibition on duplicative fees contained in 24 CFR part 883 and with paragraphs (f) and (h) of this section, as applicable to the projects to be refunded.

(c) No agency shall issue obligations to refund outstanding 11(b) obligations until the Office of the Assistant Secretary for Housing sends the financing agency a Notification of Tax Exemption based on approval of the proposed refunding's terms and conditions as conforming to this part's requirements, including continued operation of the project as housing for low-income families, and where possible, reduction of Section 8 assistance payments through lower contract rents or an equivalent cash rebate to the U.S. Treasury (i.e. Trustee Sweep). The agency shall submit such documentation as HUD determines is necessary for review and approval of the refunding transaction. Upon conclusion

of the closing of refunding bonds, written confirmation must be sent to the Office of Multifamily Housing by bond counsel, or other acceptable closing participant, including a schedule of the specific amount of savings in Section 8 assistance where applicable, CUSIP number information, and a final statement of Sources and Uses.

(d) (1) HUD approval of the terms and conditions of a Section 8 refunding proposal requires evaluation by HUD's Office of Multifamily Housing of the reasonableness of the terms of the Agency's proposed financing plan, including projected reductions in project debt service where warranted by market conditions and bond yields. This evaluation shall determine that the proposed amount of refunding obligations is the amount needed to: pay off outstanding bonds; fund a debt service reserve to the extent required by credit enhancers or bond rating agencies, or bond underwriters in the case of unrated refunding bonds; pay credit enhancement fees acceptable to HUD; and pay transaction costs as approved by HUD according to a sliding scale ceiling based on par amount of refunding bond principal. Exceptions may be approved by HUD, if consistent with applicable statutes, in the event that an additional issue amount is required for project purposes.

(2) The stated maturity of the refunding bonds may not exceed by more than one year the remaining term of the project mortgage, or in the case of an uninsured loan, the later of expiration date of the Housing Assistance Payments Contract (the "HAPC") or final maturity of the refunded bonds.

(3) The bond yield may not exceed by more than 75 basis points the 20 Bond General Obligation Index published by the Daily Bond Buyer for the week immediately preceding the sale of the bonds, except as otherwise approved by HUD. An amount not to exceed one-fourth of one percent annually of the bonds' outstanding principal balance may be allowed for servicing and trustee fees.

(e) For projects for which the Agreement to enter into the HAPC was executed between January 1, 1979, and December 31, 1984 (otherwise known as "McKinney Act Projects"), for which a State or local agency initiates a refunding, the Secretary shall make available to an eligible issuing agency 50 percent of the Section 8 savings of a refunding, as determined by HUD on a project-by-project basis, to be used by the agency in accordance with the terms of a Refunding Agreement executed by the Agency and HUD which

incorporates the Agency's Housing Plan for use of savings to provide decent, safe, and sanitary housing for very low-income households. In determining the amount of savings recaptured on a project-by-project basis, as authorized by section 1012(b) of the McKinney Act, HUD will take into account the physical condition of the projects participating in the refunding which generate the McKinney Act savings and, if necessary, HUD will finance in refunding bond debt service correction of existing deficiencies which cannot be funded completely by existing project replacement reserves or by a portion of reserves released from the refunded bond's indenture. For McKinney Act refundings of projects which did not receive a Financing Adjustment Factor ("FAF"), HUD will allow up to 50 percent of debt service savings to be allocated to the project account; in which case, the remainder will be shared equally by the Agency and the U.S. Treasury.

(f) For refundings of Section 8 projects other than McKinney Act Projects, and for all transactions which substitute collateral for, but do not redeem, outstanding obligations, and for which a HUD approval is needed (such as assignment of a HAPC or insured mortgage note), the Office of Multifamily Housing in consultation with HUD Field Office Counsel will review the HAPC, the Trust Indenture for the outstanding obligations, applicable HUD regulations, and reasonableness of proposed financing terms. In particular, HUD review should be obtained for the release of reserves from the trust indenture of the outstanding 11(b) bonds that are being refunded, defeased, or pre-paid. A proposal to distribute to a non-Federal entity the benefits of a refinancing, such as debt service savings and/or balances in reserves held under the original Trust Indenture, should be referred to the Office of Multifamily Housing for further review. In proposals submitted for HUD approval, HUD will consent to release reserves, as provided by the Trust Indenture, in an amount remaining after correction of project physical deficiencies and/or replenishment of replacement reserves, where needed. In the case of a refunding of 11(b) bonds by a public agency issuer which is the owner of the project and is entitled to reserves held under the Trust Indenture, HUD requires execution by the project owner of a use agreement, and amendment of a regulatory agreement, if applicable, to extend low-income tenant occupancy for ten years after expiration of the original HAPC

term. In the case of HAP contracts with renewable 5-year terms, the Use Agreement shall extend for 10 years after the project owners first opt-out date. The Use Agreement may also be required of private entity owners, unless the refunding is incidental to a transfer of project ownership or a transaction which provides a substantial public benefit, as determined by the Office of Multifamily Housing. Proposed use of benefits shall be consistent with applicable appropriations law, the HAPC, and other requirements applicable to the original project financing, and the proposed financing terms must be reasonable in relation to bond market yields and transaction fees, as approved by the HUD Office of Multifamily Housing.

(g) Agencies shall have wide latitude in the design of specific delivery vehicles for use of McKinney Act savings, subject to HUD audit of each Agency's performance in serving the targeted income eligible population. Savings may be used for shelter costs of providing housing, rental, or owner-occupied, to very low-income households through new construction, rehabilitation, repairs, and acquisition with or without rehab, including assistance to very low-income units in mixed-income developments. These include programs designed to assist in obtaining shelter, such as rent or homeownership subsidies. Self-sufficiency services in support of very low-income housing are also eligible, and may include, but are not limited to, homeownership counseling, additional security measures in high-crime areas, construction job training for residents' repair of housing units occupied by very low-income families, and empowerment activities designed to support formation and growth of resident entities. Except for the cost of providing third-party program audit reports to HUD, eligible costs exclude consultant fees or reimbursement of Agency staff expenses, but may include fees for professional services required in the Agency's McKinney Act programs of assistance to very low-income families. Unless otherwise specified by HUD in a McKinney Agreement, savings shall be subject to the above use requirements for 10 years from the date of receipt of the savings.

(h) Refunding bonds, including interest thereon, approved under this Section shall be exempt from all taxation now or hereafter imposed by the United States, and the notification of approval of tax exemption shall not be subject to revocation by HUD. Whether refunding bonds approved under this section meet the requirements of

Section 103 or any other provisions of the Internal Revenue Code is not within the responsibilities of HUD to determine. Such bonds shall be prepaid during the HAPC term only under such conditions as HUD shall require.

Dated: March 27, 1996.

Nicolas P. Retsinas,

*Assistant Secretary for Housing—Federal  
Housing Commissioner.*

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