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NATIONAL AFFORDABLE HOUSING MANAGEMENT ASSOCIATION

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Recognized Increased Cost (RIC) Proposal

Effective Date or Deadline

The effective date is undetermined. The proposal must be adopted by HUD before it could go into effect.

Background

The financial strain placed on affordable properties resulting from increasing energy costs and insurance costs has become a major regulatory concern for NAHMA members. Often, relief does not come soon enough to offset these unforeseen operating costs. For instance, the information used to determine HUD's Operating Cost Adjustment Factors (OCAFs) is already at least 16 months old by the time these inflation figures are published. Furthermore, underwriting for many properties that have gone through the Mark-to-Market restructuring was based on significantly lower estimates for energy and operating costs. Successive natural disasters have also placed the cost of insurance nearly out of reach for properties in Florida and the Gulf Coast.

On March 30, 2006, NAHMA and other industry partners who represent affordable multifamily housing operators met with HUD officials to discuss the hardship placed on properties by soaring costs of electricity, oil, natural gas and insurance. We requested that HUD implement some type of "real-time" mechanism to account for adjustments in utility costs, so that properties are not pushed toward financial insolvency as they try to cover this basic need for residents. Another possible solution we advocated was for HUD to provide a special rental adjustment through Section 8 to cover higher energy costs and submit updated utility surveys. HUD provided such relief in 2001, and we believed HUD's previous guidance could be a useful model for addressing the current energy cost challenges.

HUD rejected using its previous guidance from 2001 to provide relief through Section 8. HUD staff criticized the 2001 policy as administratively burdensome, costly, and inefficient. They claimed the policy provided a "windfall" to owners who received relief twice—once through the increased Section 8 and then again through an increased OCAF. HUD also felt the previous model was obsolete, since most of the portfolio now receives operating cost adjustments through an OCAF rather than a budget-based rent increase. Nevertheless, HUD staff acknowledged shortcomings in the timeliness of the OCAF process. Industry representatives were invited to follow-up with recommendations HUD could use to provide emergency, real-time relief for unforeseen operating cost increases.

NAHMA led an industry effort to identify and hire a consultant to draft such a proposal. Once the consultant, Recapitalization Advisors, Inc.[1], was agreed upon, NAHMA drew up the contract, facilitated meetings between Recapitalization Advisors and the industry partners, and arranged the August 17th meeting to present the proposal to HUD. David Smith, President of Recapitalization Advisors, explained the substance of the industry's Recognized Increased Cost (RIC) proposal to key HUD officials.

Summary

The RIC proposal was developed in partnership with and based on input from the following organizations:

- American Association of Homes and Services for the Aging;
- National Affordable Housing Management Association;
- National Association of Affordable Housing Lenders;
- National Association of Home Builders;
- National Housing Conference;
- National Housing Trust;
- National Leased Housing Association; and
- National Multi Housing Council.

From the start of the policy development process, this industry coalition sought a means of providing effective, expedited emergency operating cost relief to HUD properties which would not be subject to criticisms of past efforts. The coalition envisioned a proposal which would be:

- Broad enough to cover any unforeseen spike in operating costs outside the owner/agent's control;
- Targeted to properties with a demonstrated need for relief;
- Able to provide sufficient financial relief in a timely manner;
- Easily implemented / administered by HUD; and
- Constructed in a way which will prevent so-called "windfalls" to owners.

The resulting RIC satisfies these criteria, and is brilliant in its simplicity. The Executive Summary explains,

> **"Our proposed solution allows HUD and properties to respond quickly to mid-cycle cost increases that, had they been known during the previous rent increase cycle, would unquestionably have been included in the rent calculations.**

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[1]Recapitalization Advisors Inc., has extensive expertise in the development and application of affordable housing policy. For more information, please see www.recapadvisors.com.

Such an approach yields three regulatory consequences:

- *Baseline rents*. At the next rent increase, the property's baseline rents will be increased by the RIC, as a starting point for processing the next rent increase (budget-based, OCAF, AAF, or otherwise).
- *Market rents*. In similar fashion, the property's 'comparable market rents' will likewise be presumed to have risen by the RIC.
- *RIC borrowing costs as a project expense*. Owners who borrow funds to cover shortfalls between application and the post-RIC rent increase will have the debt service on that borrowing (a "RIC Loan") recognized as a project expense ('above the line').

This three-part RIC relief will protect properties by enabling them to cover their cash requirements without disrupting HUD's normal annual rent increase procedures and without creating a windfall to affected owners and properties."

The proposal applies to properties "whose rents are subject to HUD (or delegated contract administrator) determination or approval." It assumes that owners will borrow against future higher rents based on the recognized cost increase. Sources for RIC loans include residual receipts, replacement reserves, forgoing deposits to replacement reserves, or other sources such as owner affiliates. Also, properties could submit more than one RIC application per year.

The actual RIC proposal follows this NAHMAnalysis.

Issues of Concern to NAHMA

NAHMA strongly believes that quick implementation of the RIC proposal is imperative. Utility costs and higher taxes continue to strain the limited resources of properties across the country. In Florida and the Gulf Coast, outrageous increases in insurance premiums are threatening the viability of numerous affordable developments. Finally, as the anniversary of Hurricane Katrina has arrived, it is especially important to have the RIC tool in place before the next hurricane strikes.

Positive Aspects of This Policy/Proposal

To the best of our knowledge, the RIC proposal requires no new statutory authority or regulatory action by HUD. We believe these provisions could be immediately and easily implemented by administrative notice.

NAHMA's Position

NAHMA urges HUD to implement the Recognized Increased Cost Proposal as soon as possible.

While the RIC offers an effective way to address unforeseen operating costs for HUD-regulated properties, statutory and regulatory differences require a different approach for Low Income Housing Tax Credit (LIHTC) properties. To assist these projects, Congress should consider providing a special appropriation for energy cost relief. Moreover, Congress should also begin assessing whether the utility allowance should remain part of the gross rent formula and /or whether to change the statutory limitations on the maximum LIHTC rents.

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Recognized Increased Cost Proposal

1. Executive summary

This memorandum presents a proposal (the "Industry Proposal") on behalf and with the participation of American Association of Homes and Services for the Aging, National Affordable Housing Management Association, National Association of Affordable Housing Lenders, National Association of Home Builders, National Housing Conference, National Housing Trust, National Leased Housing Association, and National Multi Housing Council to provide a Recognized Increased Cost (RIC) in view of the last two years' experience with natural disasters, utility price spikes, and rapid escalation of insurance rates, all of which have sent reverberating shocks to operating expenses.

Our proposed solution allows HUD and properties to respond quickly to mid-cycle cost increases that, had they been known during the previous rent increase cycle, would unquestionably have been included in the rent calculations.

Such an approach yields three regulatory consequences:

- *Baseline rents*. At the next rent increase, the property's baseline rents will be increased by the RIC, as a starting point for processing the next rent increase (budget-based, OCAF, AAF, or otherwise).
- *Market rents*. In similar fashion, the property's 'comparable market rents' will likewise be presumed to have risen by the RIC.
- *RIC borrowing costs as a project expense*. Owners who borrow funds to cover shortfalls between application and the post-RIC rent increase will have the debt service on that borrowing (a "RIC Loan") recognized as a project expense ('above the line'). [1]

This three-part RIC relief will protect properties by enabling them to cover their cash requirements without disrupting HUD's normal annual rent increase procedures and without creating a windfall to affected owners and properties.

Further, to the best of our knowledge, the RIC mechanism proposed here requires no statutory change and no regulatory change; it may be adopted by administrative guidance through issuance of a Headquarters Notice.

[1] RIC Loans are modeled on Capital Recovery Payment (CRP) loans used in mark-to-market transactions.

2. Context

As dramatized by recent events such as Hurricane Katrina and the resulting jumps in hazard insurance prices, property deductibles, and utility prices, a sudden cost increase can impose disastrous short-term cash flow gaps on properties; when the increases are large enough, sustainability and affordability can be placed at risk almost immediately.

Such events as these could be addressed if they were foreseeable -- the normal annual rent-setting processes allow recognition of visible and known costs. When the cost increases are both (a) unforeseeable, and (b) severe, the rent increase procedure breaks down. The result can be rapid and widespread defaults.

To address this, HUD and owners need a solution that:

1. Allows for recognition of major *unforeseeable* events.
2. Can be applied *rapidly*.
3. Is compatible with normal procedures and does not disrupt them, nor unduly burden the Department's workload.
4. Protects properties from imminent default, physical failure, or loss of resident affordability.
5. Prevents windfalls to owners.

Our proposed solution allows HUD and properties to respond quickly to mid-cycle cost increases that, had they been known during the previous rent increase cycle, would unquestionably have been included in the rent calculations.

We propose that HUD implement a Recognized Increased Cost (RIC) mechanism for addressing a defined set of emergency cost increases. Through an enabling Housing Notice, HUD should recognize increased costs (within a defined range of increases and cost types) in advance of regularly scheduled rent increase applications. This recognition allows the property to finance the short-term costs until the next rent increase. The temporary financing provides a finite, easily-audited line item for rent increases.

Recognition has no immediate effect on rents, but it does authorize the owner to borrow (either from property reserves or outside sources) against future higher rents based on the RIC. RIC debt service becomes an automatic input into budget-based rents and adjustment to non-budget-based rent limits, which means it can be implemented through normal rent increase procedures. Once the RIC Loan is repaid, rents will adjust back at the next renewal.

The RIC mechanism is an efficient, easily-implemented, financially-controllable solution that requires no special appropriations, minimal administrative burden, and no disruption for residents. Timely implementation through a Housing Notice before the 2006 hurricane season would be ideal.

3. Cost increases create cash flow gap and erode properties

3.A. HUD properties are vulnerable to sudden, material cost increases

A sudden cost increase—such as a spike in utility costs, cleanup from a natural disaster, or an upward adjustment in insurance premiums—can occur many months before a property is eligible for a rent increase. Although in many cases HUD's normal rent increase process could address the problem, the cash flow gap in the interim before the rent increase flows to the property could be disastrous.

Possible harm to properties and residents from such unexpected cost spikes includes:

- **Physical breakdown**, either from uncorrected damage or lack of funds for upkeep, resulting in risks to the health and safety of the residents.
- **Default on the mortgage**, if lack of cash prevents servicing of the debt.
- **Lapse or gap in essential services**—e.g., hazard insurance coverage.
- **Loss of affordability**, by owners who might otherwise stay in an affordability program but see conversion to market as their only viable response to a sudden cost increase.

3.B. Cost spikes have consequences both short-term and long-term

Even if a property has enough working capital to weather the short-term dangers until a rent increase is approved, similar risks apply over the medium to long term. The rent increase only recognizes costs going forward, so whatever resources the property consumed to stay afloat (such as replacement reserves, residual receipts, postponed capital improvements, or owner contributions) are gone forever, leaving the property more vulnerable going forward.

There are two parts to the overall problem of the rent increase lag:

- *Short-term* lack of cash to meet immediate needs, and
- *Long-term* impairment in property health from accumulating lag effects.

3.C. Recent unprecedented cost increases require action now

Recent increases in insurance and utility costs are having exactly the predicted impacts, with the worst effects concentrated in particular regions. As shown in Exhibit 1, the scale of increases -- particularly in hazard insurance premiums and deductibles, and to some degree in utility costs -- is for most properties far in excess of available resources.

Action is needed now.

4. Recognized Increased Costs provide short-term cash efficiently

To solve the short-term cash flow gap, we propose that HUD implement a Recognized Increased Cost (RIC) mechanism, as an intra-year action that does not disrupt normal rent increase cycles, for addressing a defined set of emergency cost increases.

4.A. RIC concept

Through an enabling Housing Notice, HUD should recognize increased costs (within a defined range of increases and cost types) in advance of regularly scheduled rent increase applications. This recognition allows the property to finance the short-term costs until the next rent increase. The temporary financing provides a finite, easily-audited line item for rent increases.

4.B. Eligible costs

At an owner's properly documented request (see Exhibit 2 for detailed description of the application and approval process), HUD will recognize increased costs that result from:

- Hazard insurance rates, including associated escrow requirements
- Unreimbursed losses from natural disaster,
- Goods, supplies, and equipment,
- Property taxes,
- Employment benefit costs,
- Labor costs,
- Fuel oil,
- Natural gas,
- Electricity, or
- Water and sewer.

(Historical observation: HUD has recognized these categories of expense increase before: they are very analogous to the so-called 'special rent increase' expense items under applicable AAF guidance and the components of annual OCAF statistical calculations.)

4.C. 'Ex post facto' change to baseline rents and baseline market rents

Approval of the RIC does not change the property's rent schedule, but *does* have the following prospective changes:

- *Baseline rents considered to be increased by RIC*. When the owner submits for the next rent increase, the starting point will be the approved rent schedule *plus the RIC amount*. Then any budget-based, OCAF, AAF or other procedures will be applied to the RIC-plus base.
- *'Comparable market rents' also increased by RIC*. Any 'comparable rent' previously determined will likewise be increased by the RIC. (The reasoning is straightforward: the costs approved in a RIC apply to all forms of residential rental, and may be presumed to have affected all other properties, regulated or unregulated, more or less equally.)

The matching augment to comparable market rents assures that in fact the RIC cost recognition will not run afoul of other requirements that rents not exceed comparable market; if the pre-RIC rents were below comparable, then the post-RIC rents will likewise be below post-RIC comparable.

Following the payoff of the RIC Loan, normal rent increase procedures will either a) confirm that the increase remains an ongoing component of operating costs or b) if the cost increase was temporary (of only a few years' duration), impose the standard budget-based or market comparability cap on rents to prevent a windfall to the owner.

4.D. RIC Loans

Although approval of a RIC has no immediate effect on rents, the RIC Approval further will authorize the owner to borrow (a "RIC Loan") against future higher rents based on the RIC. RIC Loans may be provided from the following sources:

1. Residual receipts, if available
2. Replacement reserves, if available
3. Foregoing deposits to replacement reserves, or
4. Other capital sources (including owner affiliates)

RIC Loans will have the following terms based on the source of funding:

- Project funds (replacement reserves or residual receipts) carry zero interest.
- Other capital sources carry interest at the Applicable Federal Rate plus 300 basis points. (This rate is intended to be a simple means of approximating normal market costs for fairly creditworthy loans.)
- Repayment is on an amortizing basis over a period of one to five years.
- Debt service costs on the RIC Loan will be recognized as a project cost ('above the line,' before the surplus cash test).
- Debt service payments on the RIC Loan will be included in rent increases until the RIC Loan is repaid.

4.E. RIC Loan debt service as a component of rents

At the next regularly scheduled rent increase, HUD will authorize rents sufficient to cover the increased costs plus the debt service on the RIC Loan. Once the RIC Loan has been repaid, it will no longer be a component of rent increase calculations, so rents may fall by the amount of the RIC component at the next regular renewal. The process would be similar for budget-based and non-budget-based rents:

4. E. 1. Budget-based rents

HUD will recognize RIC Loan debt service as a component of the budget upon which rents will be calculated. If a RIC Loan is scheduled to be repaid during the coming year, rents will be set to anticipate adjustment downward at the next scheduled rent increase.

4. E. 2. Non-budget-based rents

HUD will treat RICs as automatic increases to the rents mandated by comparability, OCAF, AAF, or other rent mechanisms. In other words, a rent comparability test or fixed adjustment factor (such as AAF or OCAF) should not prevent a property from receiving an increase to cover the full cost of RIC debt service. The automatic increase will no longer apply once the RIC Loan has been repaid.

4. E. 3. Mixture of budget-based and non-budget-based rents

For properties that have a mixture of budget-based and non-budget-based rents, the RIC will be prorated on a per unit basis.

4.F. Eligible properties

Any property whose rents are subject to HUD (or delegated contract administrator) determination or approval. This includes properties in the following overlapping categories:

- Section 202
- Section 811
- Section 515 with any property-based Section 8
- Post-Mark to Market
- Post-Mark Up to Market
- Section 236
- Section 221(d)(3) BMIR
- Section 220 Urban Renewal
- Section 8 New Construction, Sub Rehab, or Mod Rehab
- Section 8 LMSA with full or partial Section 8 coverage
- ELIHPA or LIHPRHA Preserved
- Uninsured Section 8-assisted
- Any other property with project-based Section 8 assistance

Because cost shocks can occur multiple times during a single year, properties may submit more than one RIC application per year.

5. Evaluating the RIC mechanism

5.A. RIC is effective and efficient

The RIC mechanism solves the short-term cash flow gap and prevents long-term erosion of properties by efficiently using existing property resources and capital markets. It also minimizes cost to the federal government.

Advantages of RIC include:

1. *Minimal administrative burden*—implementation relies on existing rent increase mechanisms. Recognition of costs and approval to borrow occur simultaneously.
2. *No disruption to residents*—residents see no rent increase until their normal lease renewal.
3. *No federal appropriations*—rent increases are part of the normal budget-based process, so no additional appropriations are needed and no additional scoring cost should apply.
4. *Simple enactment*—administrative guidance, such as a Housing Notice, should be sufficient.

5. *Financially controllable*—outlays are tied to documented cost increases, and total obligation is known up-front. HUD has no open-ended obligation.
6. *Automatic readjustment of rents*—once the RIC Loan is repaid, rents automatically adjust downward at the next renewal. The RIC rent increase is thus inherently temporary, preventing a windfall to owners.
7. *Maximizes uses of existing property reserves*—RIC provides an auditable, controlled mechanism for allowing properties to use their own reserves to weather cost increases while allowing access to outside sources when internal funds are insufficient.

5.B. Alternatives to RIC are inferior

What else could be done to address the problem? The three alternatives we identified all had serious failings in comparison to RIC, either not resolving the problem or imposing far greater costs on HUD and program participants. The table below summarizes.

Table 5.B: Evaluation of alternatives to RIC Loans

	Alternative	*Features*	*Evaluation*
1.	Do nothing	• Requires no action	• Marginal properties fail at each shock • Strong properties weaken over time
2.	Fund Flexible Subsidy or similar emergency loan fund	• Provides short-term cash • Relies on annual appropriations	• Requires extensive processing by HUD staff • May complicate future recapitalizations • Affordability requirement of original mortgage term is obsolete • Requires Congressional action to authorize and/or appropriate funds
3.	Allow pre-renewal rent increases	• Allows Section 8 subsidy to adjust upward before renewal	• HUD staff will have to process large volumes of simultaneous applications under new procedures • Processing times may still impose short-term cash flow problems • Rent increases on budget-based properties will still have to wait for lease renewals • May require extensive new guidance, regulations, or statute to implement

5.C. RIC uses precedents from existing HUD practice

The RIC structure uses only concepts and principles that are adapted from other HUD practice:

1. RIC cost increases are adapted from Section 8 AAF 'special' rent increases.
2. RIC Loans are modeled on CRP loans in Mark to Market transactions.
3. The interim recognition and permitted borrowing analogize from many years of HUD practice in the use of project reserves and residual receipts.
4. Increasing the presumed 'comparable market rent' by the RIC amount does not preclude a future comparability determination at the next appropriate cycle (expiration of the five-year interval for MUM or otherwise).

5. RIC authorizations work within the one-rent-increase-per-twelve-months format generally provided under applicable HUD programs.
6. As far as we know, none of the RIC mechanisms require regulatory approval; the entire concept can be authorized by administrative guidance.

6. Conclusion

Timely implementation of RIC—easily accomplished through administrative guidance—would provide properties with an essential tool to survive expected cost increases without imposing significant costs on HUD.

Action before the 2006 hurricane season begins is strongly desirable.

7. Exhibits

Exhibit 1 Unprecedented cost increases burden properties
Exhibit 2 RIC application and approval process
Exhibit 3 Example RIC approval letter
Exhibit 4 Hypothetical RIC calculation

8. Supporters

This proposal is presented on behalf and with the participation of:

American Association of Homes and Services for the Aging
National Affordable Housing Management Association
National Association of Affordable Housing Lenders
National Association of Home Builders
National Housing Conference
National Housing Trust
National Leased Housing Association
National Multi Housing Council

Exhibit 1
Unprecedented cost increases burden properties

1. Summary

HUD-regulated affordable properties face unprecedented cost burdens that may overwhelm properties before their next scheduled rent increase. To illustrate, rather than exhaustively catalogue, we identify three types: insurance, utilities, and natural disasters.

2. Insurance

Since 9/11, the insurance has been undergoing an industry-wide reevaluation of risk. The disastrous 2005 hurricane season and forecasts of future bad seasons to come created further pressure on insurers to reduce exposure, with corresponding burden on the insured.

Impacts are profound and geographically concentrated. A recent survey of Florida Association of Homes for the Aging (FAHA) and Southeastern Affordable Housing Management Association (SAHMA) members in Florida and other hurricane-vulnerable states compared 2005-2006 insurance premiums to 2006-2007 premiums:

- Premium increases averaging 107 percent—more than double existing premiums—with one respondent reporting an increase of more than ten times the previous premium. No increase was less than 50 percent.
- Escrow requirements based on new premiums impose sudden costs on properties.

3. Utilities

Recent spikes in energy costs (announced increases have ranged as high as 35% for regulated utilities and 50% for unregulated) can impose sometimes insurmountable costs on properties well before a rent increase could respond. As illustration, we include examples reported by NAHMA members:

- 516 Humboldt Apartments in St. Paul, Minnesota, is a 120-unit Section 202 property with 100% Section 8 assistance. As of April 30, 2006, the property paid $69,256 in heating costs, an increase of $15,529 (22%) over the previous year. The OCAF rent increase of 2.8% did not begin until July 1, 2006.
- 508-510 Humboldt Apartments in St. Paul, Minnesota, is an 82-unit Section 202 property with no Section 8. It has seen 24% utility cost increase compared to last year. The 2.5% rent increase planned for July 1, 2006, would mostly go to utility costs, and a second rent increase is expected in January, 2007.

4. Natural Disasters

The 2005 Hurricane season imposed large repair costs on exposed properties, and special resources for clean-up are both limited and sometimes slow to manifest. Many properties could likely still benefit from a RIC mechanism to address remaining repair issues before the next hurricane season begins. Future damage could be addressed without waiting for *ad hoc* disaster funding.

Exhibit 2
Draft Administrative Notice

Purpose

HUD recognizes that uncontrollable events may occur that have severe harmful financial consequences for HUD regulated projects. In such instances, HUD will grant rent relief in the form of an emergency Recognized Increased Cost (RIC) provided the owner provides proof documentation. This notice provides procedures for processing a RIC based on HUD's prime interest is the continued financial viability of its projects. In reviewing requests from owners concerning a RIC, the Field Office should be guided by the fact that HUD-approved budgets should and must provide sufficient and adequate funding to operate the projects.

Applicability

These procedures for processing a RIC apply to the projects listed below:

- Section 202
- Section 811
- Section 515 with any property-based Section 8
- Post-Mark to Market
- Post-Mark Up to Market
- Section 236
- Section 221(d)(3) BMIR
- Section 220 Urban Renewal
- Section 8 New Construction, Sub Rehab, or Mod Rehab
- Section 8 LMSA with full or partial Section 8 coverage
- ELIHPA or LIHPRHA Preserved
- Uninsured Section 8-assisted
- Any other property with project-based Section 8 assistance

Procedures for requesting an emergency Recognized Increase Cost ("RIC")

Owners are allowed to charge only the rents shown on the rent schedule they submitted and which has most recently been authorized by HUD and/or the CA. When current rent levels are NOT sufficient to cover unanticipated or unavoidable increases in operating costs, including the following:

- Hazard insurance rates, including associated escrow requirements
- Unreimbursed losses from natural disaster
- Goods, supplies, and equipment
- Property taxes
- Employment benefit costs
- Labor costs
- Fuel oil
- Natural gas
- Electricity
- Water and sewer
- Such other uncontrollable cost increases as HUD may from time to time authorize by amendments to this administrative notice.

Owners should request that HUD approve a Recognized Increase Cost relief. Owners may make more than one RIC request in a single year.

Initial Submission

The submission to request RIC relief should include the materials listed below:

- A cover letter from the Owner to the HUD Asset Manager, or the Contract Administrator where applicable, that summarizes the reasons why a RIC is needed.
- Current HUD approved Budget Worksheet, if applicable.
- Documentation to support the RIC request such as a utility analysis, invoices, current insurance deductibles, property tax assessment, or insurance quotes. Documentation need only establish that the costs will be incurred, not that they have already been invoiced or paid.
- Calculation of the RIC amount requested based on current HUD approved budget compared to documentation of increases or unreimbursed costs, including cost of Auditor Certification.
- An executed copy of the Project Auditor’s Certification of the above calculation of RIC.
- If applicable, HUD Form 9250 requesting a release or change in deposits from the reserves.
- If applicable, authorization to borrow a RIC loan from the lending agent with the terms of the loan stated which will begin repayment with the next rent increase.

Management of the RIC process
Field Offices must establish a tracking system that will facilitate and monitor compliance with the following processing times:

The Field Office should check the completeness of the owner's initial submission within 5 working days of its receipt. Call the owner/agent and ask them to submit any missing materials and follow up in writing.

The review should be complete and a decision letter issued within 10 days after receipt of all materials required.

Notification of Implementation
Once a decision has been reached on a RIC request, the owner should be notified by letter.

The letter must:

- Explain the reasons for HUD’s decision to approve the RIC or to deny all or part of the RIC. The RIC approved can be greater than what the owner requested if justified by your analysis.
- State the total amount of the RIC and the approved source(s).
- If the RIC is for project repairs, specify which repairs are allowable and the repair budget.
- Confirm the amount and effective date of any revised replacement reserve deposits or releases from the reserves. Complete the HUD 9250 submitted by the owner or make modifications if necessary. Transmit copies of the HUD 9250 to the owner, and then to the mortgagee once the RIC Certificate is fully executed.
- Identify the terms of repayment and if the RIC is a loan, issue a RIC Loan Authorization Form.
- State a deadline for return of paperwork.
- Send the original letter along with attachments to the owner and a copy to Headquarters.

Exhibit 3
Sample RIC Approval Letter

<HUD or CA letterhead>

<Date>

<Project Owner>
<Address>

Dear Mr. Owner:

Subject: Recognized Increased Cost Relief
<Property Name>

This letter is written as HUD's (or CA) formal approval of your request for an emergency recognized cost increase. Below are the terms of the approval.

- The RIC will equal $________ which is the sum of (a) <list applicable Recognized Increased Costs> and (b) special auditing costs.
- The RIC will *not* be charged directly to residents or subsidy at this time, but instead will be recognized as an increase in:
    - The property's approved operating budget
    - The property's baseline rents (before consideration of new rent increases at the next regularly scheduled rent increase on <date>)
    - The property's comparable market rents.
- The Owner has chosen to fund the RIC from the sources (collectively, the "RIC Loan") outlined below: <outline the applicable source>

    1. A release from the Residual Receipts Fund in the amount of $______
    2. A release form the Reserve for Replacements in the amount of $______
    3. A suspension of Deposits to the Residual Receipts Fund from <date> to <date>
    4. A suspension of Deposits to the Reserve for Replacements from <date> to <date>
    5. An outside source: ________________

- The terms of RIC Loan repayment are as follows: <list applicable terms>

    (a) Project funds (replacement reserves or residual receipts) carry interest at zero interest.
    (b) Other capital sources carry interest at the Applicable Federal Rate plus 300 basis points, currently estimated at <rate> based on the short-term AFR for the last calendar month before the RIC approval.
    (c) Repayment is on an amortizing basis over a period of <number, not to exceed five> years.
    (d) Debt service costs will be recognized as a project cost exempt from the surplus cash test.
    (e) Debt service payments will be included in rent increases until the RIC Loan is repaid.

Enclosed for the signature of the Owner are three copies of the RIC Certificate and RIC Loan Authorization Form for the above referenced property. Please verify that the information, including terms and conditions, are correct and notify us of any discrepancies. The Owner must sign, date and enter his/her title on each RIC Certificate and Loan Form.

Please also review the (revised) HUD Form 9250 which authorizes the release/change of reserves.

Upon receipt of the executed RIC Certificate (and RIC Loan Authorization), HUD will countersign and return a fully executed copy to you for your files. Please contact me if you are unable to send the signed documents within 7 days of receipt of this package.

Regards,

HUD Asset Manager

Cc: Contract Specialist
HUD Headquarters

Exhibit 4
Hypothetical RIC Calculations

Property Information		
Unit mix	43	1 BR units
Sec. 8 monthly rent	$ 730	

Annual Income		
Gross Potential Rent		376,680
Vacancy	*1.00%*	(3,767)
Net Rental Revenue		372,913
Other Income		821
Total Revenue		373,734

Operating Expenses		
Management Fee	*5.00%*	18,646
Administration		40,346
Maintenance and Operating		55,867
Utilities		17,072
Real estate taxes		37,665
Hazard insurance		14,315
Other 1 -	Misc	-
Other 3 -		-
Total Operating Expenses		183,911
Replacement reserve deposits		14,400
Net Operating Inc. (NOI)		175,424
Annual debt service		174,180
Cash after debt service		1,244

Hypothetical RIC calculation for one-time cost				
Storm damage	300,000			
Covered by insurance	275,000			
Remaining cleanup costs	25,000			
Insurance deductible	10,000			
Total RIC Loan	**35,000**			
Amortization	60 months			
Interest rate	8.21%	*5.21%*	AFR plus	*3.00%*
Annual debt service constant	24.452%			
Annual payment	$8,558			
Monthly payment	$713			
Per unit monthly payment	$16.59			

applied in addition to normal rent increase
until RIC Loan is retired

Hypothetical RIC calculation for ongoing cost				
Utility cost increase, monthly	500			
Months until next rent increase	6			
Total expected outlay	3,000			
Total RIC Loan	**3,000**			
Amortization	12 months			
Interest rate	8.21%	*5.21%*	AFR plus	*3.00%*
Annual debt service constant	104.503%			
Annual payment	$3,135			
Monthly payment	$261			
Per unit monthly payment	$6.08			

applied in addition to normal rent increase,
which would include the new higher utility costs in baseline