



U.S. Department of Housing and Urban Development  
Office of Public and Indian Housing

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**Special Attention of:**  
PHAs; Field Office Public  
Housing Directors; and  
HOPE VI Coordinators

**Notice PIH 2004-5 (HA)**

Issued: April 9, 2004  
Expires: April 30, 2005

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**Subject: HUD PIH Notice for Mixed-Finance Development of Operating Subsidy-Only Projects**

HUD is issuing this Notice to provide new guidance regarding the statutory, regulatory and program policy issues involved in developing a mixed-finance Operating Subsidy-Only public housing project (the "Operating Subsidy-Only Project" or the "Project"). The term "Operating Subsidy-Only Project" refers to the development of public housing replacement units financed without the use of HUD public housing capital assistance or HOPE VI funds, but for which HUD agrees to provide operating subsidies under Section 9(e) of the U.S. Housing Act of 1937 (the "Housing Act").

One benefit of using the Operating Subsidy-Only model of mixed-finance development is its relative simplicity. It may be used to provide assistance in existing structures or used in concert with private housing production activity. Even where it is utilized in a newly developed project the PHA may not need to be involved in the initial development and construction activity. Another advantage of this model is that HUD is able to expedite its mixed-finance review and approval process since no public housing funds are being invested in the construction, rehabilitation or acquisition of the project.

**Use of Operating Subsidy in Mixed-Finance Development**

HUD provides PHAs with operating subsidy to support the cost of operating public housing units under the terms and conditions of an Annual Contributions Contract (ACC). Mixed-finance public housing projects may be "developed" (added to a PHA's ACC) by relatively conventional methods (e.g., new construction or acquisition with or without rehabilitation), or through a variety of innovative development methods and ownership structures. However, if the project will be owned by an entity other than a PHA, then it must be developed in accordance with HUD's mixed-finance public housing development regulations contained in 24 CFR part 941, Subpart F.

The provision of operating subsidy is one of several financial tools that PHAs can use to leverage other public and private funding for the development of public housing. In most mixed-finance projects, the PHA provides public housing capital assistance for development and operating subsidy for on-going operation of the public housing units in the project. However, in the case of an Operating Subsidy-Only project, the PHA commits to provide a stream of operating subsidy, but no public housing capital assistance for development or future modernization.

For example, the Housing Authority of Baltimore has agreed to provide operating subsidies to support the operation of 62 public housing units at the 212-unit Arbor Oaks project in Baltimore. No public housing capital assistance were used to develop the project; rather, the State of Maryland, the City of Baltimore, and tax credit equity provided the capital funding. A summary of this project is included at the end of Chapter 1 of HUD's *Mixed-Finance Guidebook* (referenced at: <http://www.hud.gov/offices/pih/programs/ph/hope6/mfph/>).

As with any standard mixed-finance public housing project, a project developed using only operating subsidy must conform to all statutes, executive orders, regulations and policies relating to public housing developed using the mixed-finance method. PHAs may also use the operating subsidy-only method to acquire a project; however, if the project to be acquired by the PHA or its developer was constructed with the intent that it would contain public housing units, then all statutes, regulations, executive orders and policies related to public housing development must have been followed. These requirements include, but are not limited to, compliance with Procurement requirements, Davis-Bacon Act prevailing wage rates and the Americans with Disabilities Act (ADA). Nevertheless, since HUD public housing capital assistance is not used to develop the project, the required development proposal and closing documents are more limited in scope than standard mixed-finance projects, and the HUD review process is also streamlined.

If approved, the project will be added to the PHA's ACC with the units eligible to receive operating subsidy contributions. By law, the Operating Subsidy-Only Project must be developed, operated and maintained as public housing for the term of the low-income use restrictions. Similarly, an Operating Subsidy-Only Project is subject to certain disposition restrictions. These restrictions and their implications are discussed in detail below.

### **Restrictions on Operating Subsidy-Only Public Housing Projects**

Operating Subsidy-Only Projects are subject to a number of statutory and regulatory restrictions regarding their development, operation and disposition (sale or other conveyance or encumbrance), as more fully described below:

1. *Limit on the Number of Units:* Operating Subsidy-Only Units are required to be replacement housing units under 24 CFR part 941.102(c), which imposes a limitation on the number of units (including Operating Subsidy-Only Units) a PHA may develop. Such development is limited to the lesser of the number of units that the PHA had under ACC on August 21, 1996, or the number of units for which it was receiving operating subsidy on that date, unless authorized by HUD. As replacement units developed using non-public housing funding sources, Operating Subsidy-Only Units are counted in both the Capital Fund formula and Operating Fund

formula under current regulations. However, should these units ever be modernized with public housing capital assistance, they would then be subject to the statutory 20-year use restriction period during which they would have to be operated as public housing.

2. *HUD Approval of Proposal and Closing Materials*: For an Operating Subsidy-Only Project to be eligible to receive public housing operating subsidies, the PHA must obtain HUD approval of its Operating Subsidy-Only Mixed-Finance Proposal and closing documentation in accordance with 24 CFR part 941, Subpart F, Public/Private Partnerships for the Mixed-Finance Development of Public Housing Units.
3. *Subsidy Allocation*: The amount of operating subsidies to be provided for an Operating Subsidy-Only Project, and the manner in which these funds are allocated to the public housing replacement units, must be approved by HUD and documented in the Project's Regulatory and Operating Agreement between the PHA and the Owner. See Chapter 5 of the *Mixed-Finance Guidebook* for details regarding the issues addressed in a Regulatory and Operating Agreement.
4. *Davis-Bacon Certification Regarding Projects to be Newly Constructed or Rehabilitated*: If the PHA proposes to provide operating subsidies on behalf of a structure for which construction or rehabilitation has not begun or is underway, contracts for the construction or rehabilitation of the structure must contain the provisions in Section 46 ("Labor Standards, Davis-Bacon and Related Acts") of HUD Form 5370 ("General Conditions of the Contract for Construction, Public Housing Programs"), including prevailing wage rates and overtime requirements, as established in the applicable wage rate determinations issued by the local HUD Labor Relations Field Staff. The PHA must certify to HUD that these contracts contain the provisions in Section 46 of HUD Form 5370.
5. *Nondiscrimination and Accessibility Requirements Based on Disability*. Projects must comply with Section 504 of the Rehabilitation Act of 1973, Title II of the Americans with Disabilities Act of 1990, the Fair Housing Act, as amended,<sup>1</sup> and their respective implementing regulations at 24 CFR Part 8, 28 C.F.R. Part 35 and 24 C.F.R. Part 100. Among other things, a minimum of five percent (5%) of each Project's units and all common areas, including paths of egress, must be accessible to persons with mobility disabilities, and an additional two percent (2%) of the units must be accessible for individuals with hearing or vision disabilities. The specific applicable accessibility standards are set forth in 24 C.F.R. §8.32, App. A to 24 C.F.R. Part 40 and App. A

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<sup>1</sup> Section 504 of the Rehabilitation Act of 1973, 29 U.S.C. §794, Title II of the Americans with Disabilities Act of 1990, 42 U.S.C. §12131 et seq., and Fair Housing Act, 42 U.S.C. §3600 et seq.

to 28 C.F.R. Part 36. In addition, all Projects built for first occupancy after March 13, 1991 must comply with the Fair Housing Act Accessibility Guidelines at 24 C.F.R. §100.205 and 24 C.F.R. Ch.1, Subchapter A, App. II. For further information see PIH Accessibility Notice 2003-31.

6. *Acquisition Certification:* If the units are to be acquired rather than newly constructed, the PHA and owner must certify, consistent with 24 CFR part 941.304(b), that the property was not constructed with the intent that it would be sold to the owner of the mixed-finance project.
7. *Site and Neighborhood Standards for Projects to be Newly Constructed or Rehabilitated:* Operating Subsidy-Only Projects to be newly constructed or rehabilitated must be approved by HUD with respect to the site and neighborhood standards requirements of 24 CFR part 941.202. This review is conducted by the HUD Field Office and may require significant time in some circumstances. PHAs are urged to work with HUD to determine the need for this review at the earliest possible date.
8. *Environmental Review Requirements:* Public housing projects that receive HUD assistance are subject to 24 CFR part 58 (“Part 58”) regarding the required environmental review procedures.<sup>2</sup> The review must be completed by a “responsible entity,” as defined in Part 58, except that, when requested by the PHA or a responsible entity in certain circumstances, HUD may itself perform the environmental review under 24 CFR part 50 (“Part 50”) before it approves the PHA’s proposal. In either case, the PHA may not enter into any agreement or otherwise commit funds for the development, rehabilitation or acquisition of an Operating Subsidy-Only Project, or for the provision of assistance for such a project, before the environmental review is completed and (where required under Part 58) HUD has approved the PHA’s Request for Release of Funds.
9. *Certifications:* The PHA must provide (as part of its mixed-finance development proposal) the certifications required by 24 CFR part 941.606(n)(1)(i) (legal authority); (n)(1)(ii) (competitive procurement process to select partner); and (n)(1)(iii) (obligation to develop and operate the public housing units in accordance with all Federal requirements including, but not limited to, payment of Davis-Bacon wage rates, nondiscrimination, etc.). In addition, the PHA must provide (as part of its closing submissions) the certifications required by 24 CFR part 941.610(a)(8), including, but not limited to, certifications of compliance with the 10-year prohibition on disposition under section 9(e)(3) of the Housing Act, and with the 10-year low-income use requirement under 24 CFR part 969.105(a).

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<sup>2</sup> References to Part 50 reviews in 24 CFR part 941 are no longer applicable; Part 58 now applies to mixed-finance operating subsidy only projects.

10. *New Construction Certification:* If an Operating Subsidy-Only Project involves new construction, the PHA must comply with section 6(h) of the Housing Act in the manner established in 24 CFR part 941.606(m).
11. *Low-Income Use Restrictions and Disposition Restrictions:* The Operating Subsidy-Only Project must be subject to both a low-income use restriction (in accordance with 24 CFR part 969.105(a), or successor regulation) and a prohibition on disposition (under Section 9(e)(3) of the Housing Act), both of which extend for 10 years following the end of the last fiscal year in which operating subsidies were provided on behalf of the public housing units. To enforce these restrictions, HUD requires that a declaration of restrictive covenants, in the form prescribed by HUD, be the first recorded encumbrance against the mixed-finance development.
12. *Procurement:* The PHA must procure developers and/or owners of an Operating Subsidy-Only Project using the competitive procurement process required by 24 CFR part 941.606(n)(1)(ii) and 24 CFR part 85.36.

A complete description of all possible development scenarios and their applicable approval criteria is beyond the scope of this HUD Notice. PHAs must consult with HUD's Office of Public Housing Investments and the local HUD Field Office, at the earliest possible stage of the development concept, for a preliminary feasibility determination regarding any Operating Subsidy-Only Project.

**Early Termination of  
Low Income Use  
Restrictions and  
Disposition  
Requirements**

Prior to the enactment of the Quality Housing and Work Responsibility Act of 1998 (QHWRA), HUD had the authority under section 9(a)(1)(A) to grant upfront approval to permit an early termination of the 10-year prohibition on disposition. HUD exercised this authority by agreeing in advance to approve an early termination of the disposition restrictions in the event the PHA failed to provide the owner of the Operating Subsidy-Only Project with operating subsidies because of reduced appropriations under Section 9 of the Housing Act. HUD likewise agreed in advance under these circumstances to approve a waiver of the low income use restrictions under 24 CFR part 969.105(a).

With the enactment of QHWRA, HUD continues to retain the authority (now codified at Section 9(m)(2) of the Housing Act) to reduce the term of the 10-year prohibition on disposition. However, HUD's authority to reduce the period of time of this requirement must be implemented through regulations. Until HUD issues these regulations, it is unable to reduce the term of the 10-year prohibition on disposition under section 9(e)(3) of the Housing Act.

Nevertheless, HUD has included the following language in the Mixed-Finance ACC Amendment for Operating Subsidy-Only Projects with respect to its authority under section 9(m)(2) of the Housing Act:

“The parties hereto acknowledge section 9(e)(3) of the Act prohibits the disposition of any portion of the Project before the expiration of the 10-year period beginning upon the end of the fiscal year in which operating subsidies were provided, “except as otherwise provided in the Act.” Section 9(m)(2) of the Act thereafter permits the Secretary to reduce, by regulation, the term of this prohibition on disposition. The parties further acknowledge that regulations to implement the authority in section 9(m)(2) of the Act have not yet been issued; however, in the event the Project satisfies the terms set forth in such regulations for an early termination of the 10-year prohibition on disposition, the Project may obtain the benefit of this subsequent regulatory authority. Moreover, if the Project qualifies for an early termination of the 10-year prohibition on disposition under section 9(m)(2) of the Act and HUD’s implementing regulations, the Authority may (on behalf of the Owner Entity) request a waiver of the 10-year low income use requirement in 24 CFR part 969.105(a). HUD will not unreasonably withhold its approval of such a waiver so long as the Authority has demonstrated good cause for the waiver.

Alternatively, the Authority may seek, pursuant to section 18 of the Act, to dispose of the units and thereby terminate the 10-year prohibition on disposition and the low-income use restrictions. In such case, HUD may approve the disposition of the Project from the public housing program if it determines such action to be consistent with the Act.”

**Process for HUD Review and Approval of Operating Subsidy-Only Projects**

HUD has developed a modified submission and review process for Operating Subsidy-Only Projects. The PHA is required to submit an operating subsidy-only mixed-finance proposal, along with certain closing documents described below. In reviewing these materials, HUD’s main concerns relate to whether: (a) the level of operating subsidy to be provided to the Project is appropriate; (b) the methodology for providing operating subsidies to the Project, as described in the Regulatory and Operating Agreement, is appropriate; and (c) the Project will be developed, operated and maintained in accordance with public housing requirements for the term of the low-income use restrictions.

Following HUD review and approval of the proposal and closing materials, the HUD Office of Public Housing Investments will prepare a Mixed-Finance Amendment to the ACC for Operating Subsidy-Only Projects (the “Mixed Finance ACC Amendment”). Upon execution of the Mixed-Finance ACC Amendment, and HUD approval of the final closing binders, the public housing units in the Operating Subsidy-Only Project will be added to the ACC and will become eligible to receive operating subsidies for so long as the Project remains in compliance with the public housing requirements.

**Paperwork Reduction**



## Operating Subsidy-Only Mixed-Finance Proposal

<b>Proposal</b>	
Activities; relationship of participating parties	<i>24 CFR 941.606(a)</i>
Methodology for providing operating subsidies	<i>24 CFR 941.606(c)</i>
Development description	<i>24 CFR 941.606(d)</i>
Summary of proposed management and occupancy policies, including any use of local preferences, site-based waiting lists, income tiering, etc.	<i>24 CFR 941.304(m)</i>
Relocation information	<i>24 CFR 941.606(i)</i>
If the proposal involves new construction, Section 6(h) certifications as to cost of new construction versus acquisition	<i>24 CFR 941.606(m)</i>
Certifications, such as PHA's authority to enter into the agreements, etc.	<i>24 CFR 941.606(n)(1)</i>

<b>Closing Materials</b>	
Declaration of trust and restrictive covenants and title policy which reflects recordation of these covenants prior to any other encumbrances against the development	<i>24 CFR 941.610(a)(2)(i)</i>
Regulatory and Operating Agreement	<i>24 CFR 941.610(a)(2)(ii)</i>
Management Agreement and Plan	<i>24 CFR 941.610(a)(2)(v)</i>
Certifications by PHA	<i>24 CFR 941.610(a)(8)</i>
Cooperation Agreement between PHA and locality regarding payment of PILOT and provision of services for public housing units in the project OR, if the units are taxed, a certification by the jurisdiction that the development of the units is not inconsistent with the jurisdiction's CHAS.	
Opinions of PHA's and owner's counsel acceptable to HUD	
<p><i>If applicable:</i></p> <ul style="list-style-type: none"> <li>• Any requested variations from PHA's standard lease/ grievance procedures (and affirmative statement of compliance with 966.3 and 966.52, as appropriate)</li> <li>• New form of the tenant lease</li> <li>• Elderly designated housing plan approval</li> </ul>	
<i>Additional documentation as required by HUD.</i>	