

IDENTITY OF INTEREST TRANSACTIONS IN THE SECTION 8  
MODERATE REHABILITATION PROGRAM

1. General.

This Appendix provides clarifying instructions concerning the disclosure of, and calculation of contract rents for, identity of interest transactions under the Section 8 Moderate Rehabilitation Program. Public Housing Agencies (PHAs) need to ensure that developers/owners of Moderate Rehabilitation units do not inflate real estate costs through property sales and other transactions with identity of interest entities (partnerships, family members, etc.) in order to receive higher contract rents.

2. Definition of Identity of Interest in the Moderate Rehabilitation Program.

Identity of interest means any relationship (generally based on family ties or financial interests) between (a) the seller and purchaser (prospective owner), (b) the owner and/or general contractor and the subcontractor, material supplier or equipment lessor, or (c) the owner and the lender, which would reasonably give rise to a presumption that the parties to the transaction may operate in collusion in establishing the purchase price of the property, the cost of the rehabilitation work, or the terms of the financing. Examples of identity of interest relationships follow:

- a. When the purchaser (owner) has any financial interest whatsoever in the seller or lender or is subject to a common control, or any family relationship by virtue of blood, marriage or adoption exists between the purchaser (owner) and the seller or lender.
- b. When the owner or one or more of the officers, directors, stockholders, or partners of a corporation or partnership owning or selling the property has any family tie or is an officer, director, stockholder or partner of the general contractor or lender, or has any financial interest whatsoever in the general contractor or lender.
- c. When the seller or general contractor advances any funds to the owner (purchaser) or takes stock or any interest in the owner's (purchaser's) corporation, partnership, or property as payment.
- d. When any of the parties is involved with another in an enterprise wholly separate from the Section 8 Moderate Rehabilitation project.

- e. When any relationship between the owner, seller, lender, general contractor, and subcontractor exists which would give the owner, seller, lender or general contractor control or influence over the cost of the rehabilitation contract or the price paid to the subcontractor, material supplier or equipment lessor.
- f. When any side deals, agreements or contracts are made or contemplated which would alter or cancel any of the costs related to the property purchase, the rehabilitation work or other amounts used to calculate contract rents.

### 3. Disclosure of Identity of Interest.

Since identity of interest relationships are often difficult to detect, PHAs must require applicants for the Moderate Rehabilitation Program to disclose whether or not there exists an identity of interest related to the purchase, rehabilitation or financing of the property. This disclosure can be accomplished by requiring the owner to certify that no identity of interest exists, or if there is an identity of interest, to submit a signed statement fully describing any identity of interest relationships (see attached sample disclosure). It is recommended that PHAs add the sample identity of interest disclosure to owner application forms. In any event, owners must be required to submit identity of interest disclosures prior to Agreement execution.

### 4. Rent Calculations for Identity of Interest Sales Transactions.

If the contract rents are calculated using the cost approach, the annual property debt service amount entered on Line 2 of the rent formats must be the amount of debt service for the last arms-length sales transaction and/or loans occurring after December 1979 (occurring on January 1, 1980 and subsequent dates). If the property is sold to (or additional loans provided by) an identity of interest entity, there is strong presumption that such debt does not reflect market considerations and may have been created merely for the purpose of securing higher contract rents. Therefore, the debt service used in calculating the contract rents must be the debt service existing prior to the change in ownership or placement of additional debt on the property, and the last arms-length purchase price will be used in calculating return on investment. Any exceptions to this policy must be approved in writing by the Director, Housing Development Division of the HUD Field Office. However, for all sales transactions occurring prior to January 1980 (the first year of program operation), PHAs are authorized to use the existing property debt service regardless of whether an identity of interest existed between the seller and purchaser.

PHAs should, on a routine basis, closely examine any recent indebtedness placed against the property, whether or not an identity of interest party is involved. The PHA should disallow (in the cost approach to calculating rents) any recent indebtedness which appears to have been placed in order to increase contract rents or to circumvent the rent calculation policies. In such cases, or whenever the purchase price is difficult to determine, the PHA may elect to calculate rents using the rent approach.

#### 5.Procedures for Identity of Interest Rehabilitation Costs.

When identity of interest exists (a) between the owner and the general contractor, or (b) between the owner or general contractor and the subcontractor, material supplier or equipment lessor, it is recommended that PHAs require competitive bidding, separate construction contracts, and submission of cost certifications from each identity of interest entity (see attached sample cost certification). The rehabilitation costs should be carefully reviewed by the PHA to assure that they do not exceed the PHA's cost estimates, and are comparable to the prevailing rates for such work in the area and to costs of contractors who have an arms-length business relationship. The cost of rehabilitation work to be amortized through the contract rents should not exceed the amount determined reasonable based on the PHA's initial cost estimates. It is noted that the contract rents cannot include reimbursement for owner labor or supervision (see Appendix 34).

#### 6.Identity of Interest Rehabilitation Financing Arrangements.

When an identity of interest exists in connection with the financing of rehabilitation loans or loans covering acquisition or refinancing outstanding indebtedness, the PHA should review the terms of the financing (e.g., interest rate, amortization period) carefully to insure that they are reasonable in relation to the terms typically being provided in connection with comparable, arms-length loans in the area. In calculating the contract rents for a project where such an identity of interest exists, the PHA may approve only those debt service costs which are determined to be reasonable in relation to the debt service costs which would have been incurred for comparable arms-length loans. In addition, the PHA may determine that the identity of interest is so entwined that the owner entity is really providing a rehabilitation loan to itself and that the rents should be calculated accordingly (the rehabilitation financing would be considered an owner cash expenditure and be treated as an imputed loan at 10% interest for 15 years). An example of this would be a newly established corporation consisting of the owner's spouse and children which is established to lend the owner rehabilitation funds.

7.Recalculation of Contract Rents.

If an identity of interest relationship is disclosed or discovered for units under Agreement but not under HAP Contract, the PHA must recalculate, in accordance with paragraphs 4, 5 and 6, the contract rents to be in effect at the time of HAP Contract execution. This action is consistent with Section 1.5(A) of the Agreement which specifies that the PHA may recalculate the contract rents when necessary to conform with the HUD prescribed procedures. If an identity of interest relationship is discovered for units under HAP Contract, the PHA should notify the Field Office and request further direction. Contract rents established in the HAP Contract may be reduced on a post-audit basis in order to achieve compliance with the provisions of Appendix 35.

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ATTACHMENT 1

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SAMPLE DISCLOSURE OF IDENTITY OF INTEREST

The following or similar language should be included in the PHA's Moderate Rehabilitation owner application forms:

The undersigned hereby certifies that, except as noted below, there is not now, nor does the undersigned contemplate that there will be, any identity of interest between (a) the seller and purchaser of this project, (b) the owner and general contractor and/or any subcontractor, material supplier, or equipment lessor or (c) the owner and lender. It is further certified that, except as noted, there are not and have not been any such relationships between the seller or purchaser (owner) of this project and the lender, general contractor and/or any subcontractor material supplier, or equipment lessors. The undersigned hereby agrees to immediately report to the PHA any such identity of interest relationships which occur in the future with respect to this property even though such relationships are not now anticipated.

All references to "identity of interest" herein are made in the context of the definition below, which has been read by the undersigned.

Identity of interest between the owner(s) (purchaser(s) as parties of the first part and the seller(s), lender(s), general contractor(s), subcontractor(s), material supplier(s), or equipment lessor(s) as party(ies) of the second part will be construed as existing under any of the following conditions:

(1)When there is any financial interest of or family relationship between the party of the first part in the party of the second

part;

(2)When one or more of the partners, officers, directors or stockholders of the party of the first part is also a partner, officer, director, or stockholder of or has financial interest in the party of the second part;

(3)When the seller, general contractor, subcontractor, material supplier and/or equipment lessor advances any funds to the party of the first part;

(4)When the party of the second part takes stock or any interest in the party of the first part as payment;

(5)When any of the above stated interrelationships exist between the parties of the second part;

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(6)When there exist or come into being any side deals, agreements, contracts or undertakings entered into or contemplated, which alter, amend, or cancel any of the costs related to property purchase, rehabilitation work or other amounts used to calculate contract rents;

(7)When any relationship exists which would give the owner, or seller, or lender or general contractor control or influence over the cost of the rehabilitation contract or the price paid to the subcontractors, material suppliers or equipment lessors.

Exceptions to certification regarding identities of interest (if none, so state):

Entities	Goods or Services	\$ Value
_____	_____	_____

I am aware that this certification by me may be used to induce the U.S. Department of Housing and Urban Development to make Federal funds available for this project under the Section 8 Moderate Rehabilitation Program, and that under Title 18 U.S. Code, Sections 1001 and 1010 it is a crime to knowingly make false statements to the United States on this matter and that penalties upon conviction can include a fine and imprisonment.

_____	By	_____	_____
(Owner)			(Date)

ATTACHMENT 2

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SAMPLE IDENTITY OF INTEREST REHABILITATION COST CERTIFICATION

The following or similar language should be included in the owner's cost certification documents:

The undersigned hereby certifies that: (check one)

[ ] There has not been and is not now any identity of interest between seller, owner and/or general contractor on the one hand and any subcontractor, material supplier or equipment lessor on the other.

[ ] Attached to and made a part of this certification is a signed statement fully describing any identities of interest and separate cost certifications from any individual or entity having an identity of interest with the owner or general contractor. All amounts shown have been reduced to give effect to the amount(s) of any kickbacks, rebates, adjustments, discounts, or any other devices which had the effect of reducing the actual cost.

I am aware that this certification by me may be used to induce the U.S. Department of Housing and Urban Development to make Federal funds available for this project under the Section 8 Moderate Rehabilitation Program, and that under Title 18 U.S. Code, Sections 1001 and 1010 it is a crime to knowingly make false statements to the United States on this matter and that penalties upon conviction can include a fine and imprisonment.

\_\_\_\_\_ By \_\_\_\_\_  
(Owner) (Date)

\_\_\_\_\_ By \_\_\_\_\_  
(General Contractor) (Date)