Connecticut Housing Finance Authority

State-Sponsored Housing Portfolio

Property Owner's Guide to Rent Stratification

2018

A. Introduction

Rent Stratification is the methodology to structure base rents to maximize rental revenue to a property. The tools found in CHFA's Rent Stratification workbook will provide each owner the ability to forecast a property's long term financial sustainability. Stratifying rent is vital to the sustainability of the State Sponsored Housing Portfolio (SSHP), as there are no additional operating subsidies built into the program.

Pursuant to the Connecticut General Statute Section 8-119kk-1, "base rent is the minimum rental or carrying charge determined by the Commissioner to be necessary for the operation, upkeep and long-term maintenance and capital replacement reserves of a housing development". Rent Stratification is a program where owners can comply with the Statute, without economic displacement of the current residents.

The purpose of Rent Stratification is to allow for variable rents by income level according to the Area Median Income (AMI) while continuing to fulfill an owner's mission of providing affordable housing to all eligible income levels in a community.

B. Definition of Sustainability

A property is considered to be fully sustainable when its revenue is adequate to fully support its on-going operations, including replacement reserve deposits for current and future repairs and upgrades or replacements as they become necessary without the need for any external financial support. To be considered fully sustainable, a property must support all of the following areas of operation: (Please see Exhibit A below for a more detailed breakout).

- Administrative Expenses
- Utility Expenses
- Taxes and Insurance
- Operating and Maintenance Expenses
- Replacement Reserves

C. Base Rent Stratification

It is important to note that base rent stratification does not create economic displacement of current residents. It is implemented upon unit turnover. Full implementation could take a number of years to achieve.

Rent Stratification is a long term plan for sustainability. It is the key to ensuring that all areas of a property's operations and capital replacements remain on schedule. The goal of stratifying base rents is to generate the highest possible revenue to maintain the property in its highest and best possible physical condition while continuing to fulfill its mission of providing affordable housing to all eligible applicant's income levels within the community.

Further, stratifying rents assists the property in continuing to operate independently and eliminate the need for external funds such as state or federal rental subsidy, state grants and loan financing. Stratification is a way to assign rent and applicant income target levels within an SSHP property of up to 80% of the Area Median Income (AMI) to maximize its revenue. The percentage of AMI is dictated by the program under which the property operates.

*NOTE: Excess of Base Rent is not considered in this guidebook, as it is not a guaranteed source of income to a property.

An example of this includes the following two scenarios:

Income Target	**Base rent per month**	**# of units**	**Monthly income**
Without Stratification – assuming all resident's pay minimum base rent			
N/A	$92	10	$920
N/A	$102	10	$1,020
N/A	$112	10	$1,120
			Guaranteed Monthly Rental Income without Stratification = $3,060
With Stratification – at fully implemented property-wide stratification. Note: unit mix is only an example.			
$12,000 – 17,999	$300	6	$1,800
$18,000 – 23,999	$450	18	$8,100
$24,000 – 47,600	$600	6	$3,600
			Guaranteed Monthly Rental Income with Stratification = $13,500

D. Base Rent Stratification Workbook

Understanding the impact of Rent Stratification within a property begins with CHFA's Asset Management Rent Stratification Workbook.

Detailed instructions can be found on the Instructions tab of the workbook here.

E. Rent Stratification and Capital Needs

Rent stratification is the key to maintaining a property's future capital needs. By statute, owners are required to generate rental revenue sufficient to meet operating expenses as well as fully maintain the entire property, including present and future capital improvements. It is recommended that the Capital Needs Assessment be professionally updated every five years to allow for accurate financial planning.

F. Evaluating Monthly Per-Unit Operating Cost versus Average Monthly Net Income

The monthly per unit operating cost includes a property's total operating cost, reserve deposits, capital plan replacements (if reserves are underfunded) and debt service divided by the number of units in the property then divided by twelve months. Consider the following example:

Property A – 40 Units – Calculate Monthly Per Unit Operating Cost

Annual Operation Expense	$125,950
Replacement Reserve Deposits	$ 27,700
Capital Plan Recommendation*	$ 25,000
Debt Service	$100,000
Total Operations	**$278,650/40/12 = $580.52 Monthly Per Unit Operating Cost**

*Only include if property's reserves are underfunded.

In this example, the monthly per unit operating cost break-even rent rate is $580.52, this is the monthly amount it is costing the owner to operate one unit in Property A.

Property A - 40 Units – Calculate Average Monthly Net Rental Income

Base Rent Revenue – Gross Potential	$154,220
Excess of Base	$ 88,500
Vacancy Loss	($ 3,500)
Net Rental Revenue	**$239,220/40/12 = $498.37 Monthly Net Rental Income**

Monthly Net Rental Income of $498.37 minus the Monthly per Unit Operating Cost of $580.52, shows in this example, Property A is operating at a deficit of **$82.15** per month, per unit. This owner will have to review either the vacant Unit Distribution mix and/or the potential rent levels on the Input Page of the stratification workbook. It is recommended that the monthly per unit cost and the monthly net rental income be reviewed on a quarterly basis.

In Section 3 on the input page, the average monthly net rental income is calculated based on the inputs. It is compared to the average monthly per unit cost operating cost as calculated above. The form is designed to alert you if the monthly per unit cost is greater than the average monthly rental income.

G. Rent Stratification Transition

Rent stratification is a great approach to optimizing a property's net rental income, to accommodate the lower income applicants with the rental income from the higher applicant's rent. However, the implementation of this program takes numerous steps and will be achieved based on a property's unit turnover rate. **NOTE: Stratified rents are not to be implemented until steps one through three have been completed.**

The following is a list of steps to transition from a set base rent throughout the property to rent stratification:

Transition Step One

Populate Rent Stratification Workbook and Establish Rent Stratification Policy Amounts:

- Populate all yellow areas of the Stratification workbook including the input and cash flow tabs. See the Rent Stratification Guidebook and instructions tab for guidance on completing this step.
- During this step, enter the current property budget, capital needs recommendations for the next fifteen years and the current balance in replacement reserves.
- The input tab will include the most recent Tenant Profile data, along with entering desired rent levels and unit distribution goals.

Evaluate Monthly Per Unit Operating Cost (MPUOC) vs Net Rental Income (Found on cash flow tab):

- Once step one is completed, evaluate the property's Monthly Per Unit Operating Cost (MPUOC) and compare it to the property's current Net Rental Income Per Unit (NRIPU). The following is the formula to use for this comparison.
    - MPUOC= Total Operations + reserve deposits + debt service+ capital plan recommendation/# of units/ 12 months.
    - NRIPU = Base Rental Income + Excess of Base -Vacancy Loss /# of units / 12 months
- If the MPUOC is greater than the NRIPU, the property is currently operating at a deficit.

- Re-visit the input page and increase the potential rent level amounts and/or Unit Distribution Goals to ensure that the Net Rent Income is equal to or greater than the Monthly Per Unit Operating Cost.

Confirm Positive Cash Flow:

- After the rent levels and unit distributions goals are re-visited, review the cash flow tab to ensure the stratification plan allows for a positive cash flow over the next fifteen years (The Cumulative Reserve Balance should never be negative.)

Transition Step Two

Establish New Tenant Selection Policy:

- Create new tenant selection policy and incorporate the new rent targets and vacant unit distribution goals as created in Rent Stratification Workbook. (See CHFA revised Tenant Selection Policy Template on CHFA website)
- Incorporate the new targeted rent levels and vacant unit distribution goals into CHFA Tenant Selection Policy Template
- Housing Authority attorney to review final Tenant Selection Policy for any legal conflicts

Schedule Meeting of Board of Commissioners to Adopt Tenant Selection Policy:

- Schedule Board Meeting and include the review and discussion of new Tenant Selection Policy
- Notify residents and public of next scheduled Board meeting and include the agenda within the announcement
- Present the proposed tenant selection policy to public at scheduled meeting
- Announce thirty (30) day public comment period on the proposed tenant selection plan, during meeting.
- Include within the announcement, a central location where comments are to be submitted during the thirty (30) day comment period.

During the 30 Day Public Comment Period:

- Collect all comments, and maintain in central location
- Schedule next Board meeting to review and discuss all received comments.
- **Reminder**: During this period, all vacant units are leased at the currently approved base rent amount. New stratified rents cannot be implemented until new tenant selection policy is fully adopted.

Transition Step Three

Completion of 30 Day Public Comment Period:

- The Board reconvenes at the end of 30 day public comment period.
- Review and incorporate any additional comments received during public comment period.
- **NOTE:** If the rent levels or the vacant unit distributions are changed as a result of public comments received, the Housing Authority must repeat 30 day public comment period steps above.

Post Public Comment Period:

- Board of Commissioners adopts new Tenant Selection Policy with Rent Stratification Plan.
- Prepare next fiscal budget in accordance with Rent Stratification Plan based on potential vacancy turnover rate. Be sure to complete the budget breakdown page of the Budget Workbook appropriately.

Transition Step Four

Full Implementation:

- Executive Director to implement Rent Stratification.
- Notify existing residents as well as waitlist of the policy change and apply Rent Stratification to the current applicants on the existing waitlist.

NOTE: Thorough recording is mandatory in this process for future reference.

- At next vacancy:
  a. Executive Director reviews Vacant Unit Distribution Goals to determine the next unit rent level available.
  b. The Executive Director offers the unit to the next person on the waitlist, at the available unit rent level. If refused by applicant, the applicant's place on the waitlist does not change. Go to the next applicant until the unit is rented.
  c. If no one on the list accepts the unit, return to the top of waitlist and offer the next lowest rent level to each person on the waitlist. Repeat process.

Marketing Efforts:

- The Executive Director shall begin to affirmatively market the property in order to meet future vacant unit distribution goals.
- New applicants will be added to the bottom of the existing waitlist.
- Utilize all marketing outlets to increase applicants on waitlist.

NOTE: If the Board decides to change the vacant unit distribution after the new tenant selection policy has been adopted, no 30 day public comment period is required, only a Board resolution and a notice to the existing residents is required. This abbreviated process does not apply to changes in rent levels. All steps above must be followed prior to full implementation of the change.

H. Tenant Selection Plan and Wait List Management

Updating the Tenant Selection Plan to accommodate Rent Stratification is mandatory. Future marketing and Tenant Selection Plans can include the income targets that owners intend to market the vacant units.

CHFA strongly urges SSHP owners to consult an attorney to review the property's Tenant Selection Plan, prior to implementation. The current order of the waitlist, determined by the Tenant Selection Plan (Lottery or Point System), does not change. Refer to the Tenant Selection Plan Template found here and state regulations for more in-depth information.

Waitlist Management and Tenant Selection Methodology can be found here in Sections 8-37ee-1 thru 8-37ee-314 of the CT General Statutes.

For further information on Waitlist Management, please contact DOH or your Asset Manager.

I. Marketing and Advertising

Once a property implements Rent Stratification, the owner shall re-visit the marketing and advertising strategies currently in place to attract applicants to meet the stratification goals.

The SSHP properties have restrictive budgets, and should consider all avenues of advertising, including those that are free such as on www.cthousingsearch.org, regardless of unit availability. Social media outlets are a valuable resource for advertising where you can highlight a property's amenities, post pictures of the property as well as showcase social events.

Disclaimer:

This document is a reference guide for State-Sponsored Housing Portfolio (SSHP) owners and housing authorities. It is designed to provide a basic concept overview and to answer frequently asked questions. This guide should be a useful resource for SSHP owners and housing authorities to better understand the methodology of Rent Stratification.

Exhibit A: Areas of Operation

- Administrative expenses
  - Advertising and Marketing
  - Office supplies
  - Management fee (Applicable)
  - Legal
  - Audit
  - Office salaries
  - Resident services
  - Etc.
- Utility expenses
  - Water
  - Sewer
  - Electricity
  - Natural gas
  - Fuel oil/coal
- Taxes and Insurance
  - RE taxes
  - Payroll taxes
  - Property and Liability Insurance
  - Worker's Comp Insurance
  - Etc.
- Operating and Maintenance expense
  - Repair material
  - Repairs payroll
  - Snow removal
  - Outside contractors
  - Etc.
- Replacement Reserve
  - Maintain state minimum reserves based on program type:
    - $1,500 per unit – family
    - $1,000 per unit – elderly
  - Conduct annual capital improvements, as scheduled in the property's Capital Needs Assessment (CNA) Report
  - Replacements include:
    - Kitchen cabinets
    - Flooring
    - Paving
    - Roof replacements
    - Sidewalks
    - HVAC replacements
    - Electrical panels
    - Etc.