

**Multifamily Housing Policy Handbook
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UNIT 6 ASSET RESTRUCTURING

CHAPTER 6.3 INTEREST RATE REDUCTION

6.3.1 DEFINITION AND PURPOSE

A. Definition

The interest rate reduction (IRR) is a process used to reduce the rate of interest on an insured mortgage.

B. Purpose

The purpose of the IRR is to reduce the rate of interest and re-amortize an insured loan to significantly improve the property's cash flow.

6.3.2 APPLICABILITY

Projects subject to mortgage insurance under Section 223(f) and Section 223(a)(7) are eligible to request an IRR. Insured loans requiring HUD to waive prepayment penalties or override lockout provisions are not eligible.

A. Section 202 and Section 223(f) Debt Service Savings

Borrowers may realize significant debt service savings from an IRR. For Section 202 and Section 223(f) loans, debt service savings may be used to operate the project or be deposited in the project's reserve for replacement (RfR) account. Any debt service savings not used for operations or deposited in the project's RfR account flow directly to residual receipts and are subject to sweep.

To deposit debt service savings into a property's RfR account, the borrower must present to HUD a capital needs assessment (CNA) to confirm the additional deposits into the RfR account are warranted. A new CNA is not required to fulfill this requirement. An existing CNA may be used to substantiate the additional deposits, if those deposits are justified by needs identified in the initial 10-year CNA window. Alternatively, the borrower may obtain and use a new CNA to establish RfR levels.

B. Subsequent Refinancing of Section 202 Mortgages

Under the HUD's current guidelines, a project with a Section 202 mortgage retains its eligibility to renew, under option four of the [Section 8 Renewal Policy Guide](#), and retains its exemption from debt restructuring, under the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA) through a first refinancing. A project loses that exemption and is subject to mark-to-market (M2M) restructuring if it is refinanced a second time. A nonprofit owner of an

1 exempt property may use debt service savings resulting from a refinancing for
2 any project-based purpose. Loss of the exemption results in a review of the
3 property's budget, with the possibility of a rent reduction if rental income exceeds
4 operating costs of the property.

5 For the purposes of this policy, an IRR does not constitute a refinancing action.
6 Thus, a property with a Section 202 mortgage that has refinanced once and
7 subsequently undergoes an IRR retains its current refinancing and exemption
8 status.

9 C. Using Operating or Reserve Funds for an IRR

10 To obtain an IRR, certain processing fees are typically paid to the
11 lender/servicer. Nonprofit organizations may borrow funds from the operating or
12 reserve account of the property to pay the fees associated with an IRR. The
13 borrowed funds must then be repaid with the savings created as a result of the
14 IRR. For-profit owners requesting an IRR may not borrow funds from the
15 operating or reserve account of the property to pay associated fees.

16 **6.3.3 SUBMISSION REQUIREMENTS**

17 A. Mortgagee Responsibilities

18 Lenders/servicers should submit a package to their local Regional Center and/or
19 Satellite Office requesting an IRR. The package submitted to the Regional
20 Center/Satellite Office for review should be sent in accordance to the instructions
21 listed below.

22 B. Current Loans

23 Current loans are defined as those loans that have not been in financial or
24 technical default within the past 24 months.

25 1) The submission package for current loans must include:

26 a) a summary of the transaction detailing the projected change in interest
27 rate;

28 b) a certification from the lender stating they will obtain Government National
29 Mortgage Association (GNMA) approval for prepayment of the security
30 holders, prior to implementation of any IRR if the current loan has been
31 securitized via GNMA

32 c) a debt service coverage ratio (DSCR) analysis at the estimated interest
33 rate;

- 1 d) sources and uses statement prepared for the borrower:
- 2 i) third party lender costs, such as attorney fees, GNMA, title, and
- 3 recording costs, must be disclosed, whether paid by the lender or
- 4 owner; and
- 5 ii) such costs may not be added to the principal;
- 6 e) a full disclosure of the amount of trade profit, provided to the borrower and
- 7 HUD, if:
- 8 i) trade profit is used for something other than lender/servicer costs; or
- 9 ii) the lender/servicer waives normal costs (interest);
- 10 f) the most recent interim and annual financial statements;
- 11 g) draft mortgage documents initially prepared by outside counsel for the IRR
- 12 request to be reviewed by the local HUD Office of General Counsel (OGC)
- 13 regional center and/or satellite office counsel:
- 14 h) a CNA, if the project's final endorsement was more than 10 years from
- 15 date of the IRR request or if the current CNA is older than 10 years:
- 16 i) a CNA can be paid for out of the project's RfR account;
- 17 ii) the lack of sufficient funds to pay for a CNA is sufficient reasoning for
- 18 not completing an IRR; and
- 19 iii) the regional center and/or satellite offices may require a CNA for
- 20 projects where a CNA is not yet 10 years old, based on the age of the
- 21 property, Real Estate Assessment Center (REAC) scores, and/or
- 22 HUD's knowledge of the property;
- 23 i) a prepaid envelope for returning executed documents to the lender/servicer
- 24 for filing.
- 25 2) The documents to provide to local regional center and/or satellite office
- 26 counsel (in draft and final form, at the appropriate stage in the application
- 27 process) include the following:
- 28 a) the modification of note;
- 29 b) the modification agreement modifying the deed of trust/mortgage, with the
- 30 final agreement either certified by the title company or stamped by the
- 31 recorder's office with the date of recording and document number;

- 1 c) an ALTA 11-06 Mortgage Modification Endorsement to confirm continued
2 first mortgage status post-modification and no intervening recorded liens
3 or encumbrances; If the ALTA 11-6 is not available to state law, then a pro
4 forma/final date-down title policy endorsement to bring the policy forward
5 to the date of the modification;
- 6 d) a current authorizing resolution and incumbency certificate of the
7 borrower, any general partner, or any managing member, as appropriate,
8 confirming the organizational documents are current and have not
9 changed;
- 10 e) the borrower's approval of the modification terms;
- 11 f) the signatory authority of borrower's representative to execute the
12 modification documents;
- 13 g) a certification of changes from borrower's counsel that:
- 14 i) no additional changes will be made prior to execution and/or recording
15 of the revised documents;
- 16 ii) after the local regional center and/or satellite office counsel has
17 reviewed preliminary documents as part of the approval process; and
- 18 iii) the final documents are submitted post approval;
- 19 h) a certification from the lender/servicer stating they will obtain GNMA
20 approval for prepayment of the security holders, prior to IRR
21 implementation;
- 22 i) verification from GNMA's online database that the loan is not subject to a
23 lockout; and
- 24 j) an executed IRR request checklist (except OGC confirmation section).
- 25 Regional center and/or satellite office counsel may also determine additional
26 documents (e.g., borrower and principal organizational documents to verify
27 signing authority or an opinion from the borrower's attorney as to the
28 execution and validity of the documents) are necessary to effectuate the IRR
29 in a particular jurisdiction or for a transaction. Accordingly, the local regional
30 center and/or satellite office should consult with regional center and/or
31 satellite office counsel early in the process to see if additional documents are
32 necessary to complete the legal review.

1 C. Defaulted Loans

2 Defaulted loans are defined as those loans that are, or have been in, financial or
3 technical default within the last 24 months. For these loans, the following must be
4 included in the package to the Regional Office/Satellite Center:

5 1) a CNA and a discussion of RfR account adequacy, with the multifamily
6 regional director having the authority to waive the CNA requirement if:

7 a) the project was recently constructed;

8 b) substantially rehabilitated; or

9 c) a CNA was conducted within the past 5 years and the project is in good
10 physical condition, as documented by REAC scores and/or HUD's
11 personal knowledge of the property;

12 2) an explanation of specific problems, events, and trends causing or
13 contributing to the default and how this transaction proposes resolution; and

14 3) an explanation of where funds are obtained to bring the loan current, fund the
15 RfR account, and resolve any outstanding payables.

16 **6.3.4 Approval Process**

17 For current loans (defined in section [6.3.3. A](#) above), if there is no request for use of the
18 trade profit for anything other than lender/servicer costs, the regional center and/or
19 satellite office prepares and sends the approval letter to the lender. Once a full packet
20 has been submitted to the regional center and/or satellite office for review by the
21 lender/servicer, the final recommendation should be processed by the regional center
22 and/or satellite office within 20 business days of receipt.

23 For defaulted loans (defined in section [6.3.3. B](#) above) or loans in which the trade
24 premium is used for other than prepayment penalties or lender costs, a memorandum
25 should be forwarded to the OAMPO Director at HUD recommending approval of the
26 IRR, the completed and executed checklist, and any other documentation necessary to
27 understand the regional center and/or satellite office recommendation. HUD reviews the
28 submitted documentation and notifies the regional center and/or satellite office of
29 approval or disapproval.

30 The lender/servicer must send a copy of the recorded documents to the regional center
31 and/or satellite office for their files.

1 **6.3.5 REFERENCES**

- 2 HUD memorandums dated April 19, 2013; July 26, 2013; and HUD Memorandum,
3 [Clarification of Policy Surrounding Interest Rate Reductions](#)