Multifamily Housing Policy Handbook
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UNIT 8 ASSET DEFAULTS, CLAIMS, AND FORECLOSURES

CHAPTER 8.2 PARTIAL PAYMENT OF CLAIMS

8.2.1 PURPOSE

The purpose of this chapter is to provide guidance on Partial Payment of Claims ("PPC"). PPC are intended to assist the Owner[1] with meeting project debt obligations while averting a full claim against the FHA General Insurance Fund when an FHA-insured loan goes into default due to circumstances determined to be beyond the Owner's control. PPC are typically performed on loans for unsubsidized, market-rate multifamily projects. A PPC results in a claim against the FHA General Insurance Fund, but it may be warranted by the need to preserve and create affordable housing. The reduction in the project's first mortgage principal balance enables FHA to help stabilize the project for the long term. Thus, potential benefits of PPC include preserving or providing affordable housing, stabilizing project operations, curing an existing default, and maximizing longer term returns to the FHA General Insurance Fund.

In order to avoid a full insurance claim and assignment of the mortgage to HUD, the Department pays mortgage insurance benefits to the mortgagee for a portion of the unpaid principal balance ("PPC Claim") and recasts the remaining principal balance of the mortgage under terms and conditions determined by HUD in the form of a second Note (the "PPC Note") secured by a new second mortgage obligation (the "PPC Mortgage"). The PPC Note is in the amount of the PPC Claim plus overdue interest on the old first mortgage. The PPC Note obligates the Owner to pay 75 percent of the project's annual surplus cash flow as repayment on the PPC loan. The Owner will be required to enter into a 20-year HUD Use Agreement. Finally, HUD will waive the deduction of one percent of the mortgage funds advanced to the mortgagor, provided for in 24 CFR 207.259(b)(2)(iv), with respect to a PPC. (See 24 CFR 207.258(b)(d)).

The formal PPC process begins when the mortgagee is eligible to assign an FHA-insured mortgage in accordance with 24 CFR 207.258 to HUD and reinstatement is unlikely. Prior to the Department's processing of the PPC proposal, the mortgagee and the Owner must voluntarily agree to accept a partial payment of the insurance claim in accordance with the terms detailed in this Chapter. As outlined below, the Owner must demonstrate conditions contributing to the default that are within the Owner's control have been resolved, project operations and occupancy are stabilized, and the PPC is likely to result in long term stability of the project. The mortgagee must waive any prepayment and lock out provisions in the mortgage. The requirements of Mortgagee Letter 87-9, pertaining to prepayment and lockout provisions for bond-financed projects, are met by following the requirements of this Chapter.

[1] HUD uses Owner as a single reference to include but not be limited to principal, mortgagor, and mortgagor entity. It may also refer to the controlling individual in an ownership entity, for example, managing member or General Partner.

Owners of projects in danger of defaulting should be in discussions with their project's HUD Account Executive early on, and must provide Monthly Accounting Reports ("MAR") every month well in advance of and throughout the processing of a request.

The application process begins when an Applicant (hereinafter defined) submits a request to the Multifamily Regional Center or Satellite Office for a PPC (the "Application"[2]) signed by the Applicant's legally authorized agent. Typically, Applications are prepared and submitted by the mortgagee, although the Owner must concur with the Application and execute certain documents, so the term "Applicant" is used below with reference to both parties.

A PPC Application may be submitted to either the Multifamily Regional Center or the Satellite Office, whichever Office is closest to the property. The Multifamily Regional Center or Satellite Office[3] that obtains the complete Application, must undertake the threshold review described below, and complete a detailed analysis. If the Application receives preliminary approval by the Multifamily Regional Center or Satellite Office, the Application is transmitted to the Office of Asset Management and Portfolio Oversight ("OAMPO") at Headquarters for final review and approval. If the Application is not approved by the Regional Center and Satellite Office or is incomplete, the Application must immediately be returned to the Applicant notating the deficiencies in writing.

[2] The term Application shall mean the documentation submitted by a mortgagor or mortgagee to support a request for HUD to consider whether or not to offer a PPC to the mortgagee.
[3] The Multifamily Regional Center or Satellite Office Director are to be involved in any approval or decline of an Application.

8.2.2 APPLICABILITY:

A. Mortgages that are Eligible for a PPC Under this Chapter

Section 207: Multifamily Housing Mortgage Insurance

Section 213: Cooperative Housing Mortgage Insurance

Section 220: Mortgage Insurance for Urban Renewal

Section 221(d): Low-cost and moderate-income mortgage insurance-except for coinsured or formerly coinsured

Section 223(f): Except for coinsured or formerly coinsured

Section 542(c): HFA Risk Share[4]

[4] Risk Share properties, the maximum amount of the PPC is equal to the amount of relief provided by the HFA in the form of a reduction in principal and a reduction of delinquent interest due on the insured loan times the lesser of HUD's percentage of the risk of loss or 50 percent.

B. Mortgages That Are Ineligible for a PPC Under This Chapter

Section 203: Single Family Mortgage Insurance

Section 257: Hope for Homeowners Program

Section 234: Condominium Ownership Mortgage Insurance

Section 232: Health Care

Section 236: Mortgage Insurance and Interest Reduction Payments for Rental Projects

Section 242: Hospitals

Part 244: Group Practice Facilities

Part 251: Coinsurance for the Construction or Substantial Rehabilitation of Multifamily Housing Projects

Part 255: Coinsurance for the Purchase or Refinancing of Existing Multifamily Housing Projects (i.e., projects coinsured under Section 223(f))

Formerly coinsured mortgages that have been converted to full insurance under Section 207 of the National Housing Act including Section 221(d) of the National Housing Act

The Office of Multifamily Housing Programs has elected not to exercise the authority under Section 541 of the National Housing Act to process PPC with respect to the types of multifamily projects listed in this Section 8.2.2 and lacks authority to process PPC for the programs listed above that are not multifamily (i.e., Section 203, Section 257, Section 234, Section 232, Section 242, and Part 244) since none of these are under the purview of the Office of Multifamily Housing Programs.

8.2.3 REGULATORY REQUIREMENTS

A. Applicable Regulations for a PPC

The applicable regulation for PPC is 24 CFR Part 207.258b titled: “Partial payment of claim.” Prior to approval of a PPC, the Federal Housing Administration (FHA) Commissioner must, at a minimum, make the following findings:

1) The mortgagee is entitled, after a default under 24 CFR 207.255, to assign the mortgage in exchange for the payment of insurance benefits;

2) The relief resulting from partial payment, when considered with other resources available to the project, would be sufficient to restore the financial viability of the project;

3) The project is or can (at reasonable cost) be made structurally sound;

4) The management of the project is satisfactory to the FHA Commissioner, as shown by a rating of at least "Satisfactory" on the most recent management review;

5) The default under the insured mortgage was beyond the control of the Owner;

6) The project is, or potentially could serve as a low and moderate-income housing resource;

7) The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and other liens approved by the FHA Commissioner;

8) The mortgagee has voluntarily agreed to accept a PPC under the mortgage insurance contract and to recast the remaining loan amount under terms and conditions prescribed by the FHA Commissioner; and

9) The Owner has agreed to repay to the FHA Commissioner an amount equal to the partial payment of claim, plus overdue interest on the old first mortgage, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the FHA Commissioner. The terms of the second mortgage will be determined on a case-by-case basis to ensure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast FHA-insured mortgage.

8.2.4 OWNER AND MORTGAGEE REQUIREMENTS

A. Threshold Requirements for a PPC

1) The Owner must meet the regulatory requirements set forth in Section 8.2.3 above before the mortgagee may participate in a PPC;

2) The mortgage must be in default at the time of the Application and must remain in default throughout the entire review/approval process, including PPC closing;

3) The Application must demonstrate that the default is beyond the Owner's control, conditions contributing to the default that are within the Owner's control have been resolved, the project operations and occupancy are stabilized, and a PPC is likely to result in long term stability of the project;

4) The Application must demonstrate that all possible financial resources available to the project have been utilized, including making all capital or equity calls, fulfillment of all guaranties, and/or drawdown on all available lines of credit. The General Partner, Managing Member, and/or other owner-entity related parties often provide operating, working capital, and other types of cash flow related guaranties for projects. These guaranties are generally documented in the Partnership or Limited Liability Companies Agreement, and/or in the financial statement notes. Also, they could be documented in separate agreements. To ensure that HUD does not approve a PPC when such guaranties remain in effect or other resources remain available, Applications must include partnership or LLC agreements and any other relevant guarantee documents, as well as certifications as to the presence and status of all guaranties;

5) The Owner must not have any other loans in any of HUD's programs that are in default (unless any default was beyond the control of the Owner), and the Owner must not be in violation of any HUD regulatory or business agreements, including Housing Assistance Payment ("HAP") contracts or Use Agreements pertaining to any other property, including properties that have benefitted from PPC or other workouts in the past;

6) The Owner must have made Net Equity Contributions equal to or greater than five percent of the original mortgage amount, after final endorsement (or after the date of a subsequent HUD-approved Transfer of Physical Assets). Contributions made prior to final endorsement will not be considered in the five percent calculation described below. Net Equity Contributions are defined as equity contributions or advances made by the Owner, less repayments to the Owner from the project's accounts. Owner contributions must have been in the form of cash. However, for non-profit Owners, in-kind services may be considered. Although payment of accounts payable may be allowed, accrued but unpaid Identity-of-Interest ("IOI") expenditures (for management, ground leases, or similar costs) generally may not be considered as equity contributions unless requested and approved by the Multifamily Regional Center or Satellite Office in advance of the PPC closing. In these cases, such fees must be converted to a Note and future (after PPC closing) fees must be treated similarly for years in which surplus cash is negative. The Owner's equity contributions can only be repaid from future distributions of the Owner's share of surplus cash. Equity contributions and funds derived from operating guaranties are generally not included in the calculation of Net Equity. HUD includes in the Net Equity calculation only funds that were not committed prior to final endorsement. Accordingly, investors' scheduled installment payments will not be included in the five percent equity contribution because they will have been committed in advance of final endorsement. However, one exception may be made, at HUD's discretion. If investor installment payments have not all been made when an Application is submitted to the Multifamily Regional Center or

Satellite Office, and the Owner agrees to use all or part of the remaining installment payment(s) to reduce the amount of the PPC, such amounts will be treated as Equity for purposes of the five percent Net Equity calculation. If this is the Owner's intention, then a written commitment to this effect should be provided in the Application. Similarly, if a guarantee is executed prior to final endorsement, then funds paid in as a result of obligations under the guarantee will not be counted toward the five percent equity contribution;

7) The Owner's cash flow projections must reflect the ability to support a recast insured mortgage of at least 50 percent of the current outstanding mortgage with a debt service coverage ratio, including Mortgage Insurance Premium, of 1.20;

8) The Owner must have submitted and continue to submit all net cash monthly to the mortgagee once the loan is in default;

9) At the time of application, the mortgagee must submit a letter agreeing to accept a PPC with terms consistent with the requirements of this Chapter;

10) Low-Income Housing Tax Credit ("LIHTC") projects introduce greater underwriting complexity with respect to the ownership structures (LLCs or General Partnerships) and the financial obligations of various parties involved. Generally, HUD's position is that all outstanding financial commitments to the project must be fully funded and/or expired prior to processing approval of a PPC, and this premise guides HUD's practice for LIHTC projects as well. The treatment of LIHTC investor equity payments is addressed here, while the topic of operating deficits and similar guaranties among partners, common in non-LIHTC projects as well, is addressed in 8.2.4 (A4) above; and

In LIHTC financing, investors make a series of equity payments tied to development benchmarks and they are reserved to fund certain costs. In some cases, Applications have been submitted before the final installments have been paid. HUD will generally require such payments to be used to reduce the PPC. As noted above, if these installment payments are used to reduce the PPC they will be counted toward the Owner's five percent Net Equity Contributions.

8.2.5 MORTGAGEE TERMS AND USE RESTRICTION

A. Terms of the Recast First Mortgage/Note:

1) The interest rate for underwriting of the recast first mortgage will be no higher than 125 basis points over the 10-year Treasury Rate (rounded to the nearest tenth). Be reminded that this is the interest rate for underwriting and approval. The actual interest rate on the recast first mortgage is based on the rate in the month of closing, when the parties have rate-locked. This rate must be a fixed

rate and the mortgage must fully amortize over its term. Mortgagees are encouraged to place the loan at a more favorable interest rate than the current rate. Any reduction from the approved rate will provide additional cushion to the recast note and will benefit the Owner and project on a long term basis;

2) Late fees accrued since the last payment and costs to close cannot be included in the transaction or paid by the project in the future;

3) HUD will include interest computed from the "Paid through Date" on the loan based on the actual number of days in a 365 or 366-day year, in the PPC Note. The mortgagee cannot collect more interest than that amount from project funds;

4) Cash held in suspense by the mortgagee will be allowed by HUD to be used at closing to pay reasonable closing attorney fees, title and recording fees, escrow shortages, actual bond or GNMA fees, and interest for the remainder of the closing month. The PPC will not be increased if project cash is insufficient to cover these costs;

5) The mortgagee must agree that all prepayment lock-out and/or penalty provisions are overridden by the PPC; and

6) The mortgagee cannot charge the project a fee for processing a PPC.

B. Terms of the PPC Note and Mortgage:

1) The PPC Note has a principal amount equal to the amount of the PPC claim plus overdue interest;

2) The PPC Mortgage is in second lien position;

3) The Note interest rate is equal to the long term annual Applicable Federal Rate ("AFR") for the month of closing;

4) The term is equal to the remaining term of the first mortgage;

5) The project Owner must make annual payments on the PPC Note in the amount of 75 percent of the project's surplus cash for each year; and

6) The loan documents must have a due on sale or refinancing requirement.

C. Use Restriction

If the property is already subject to a Land Use Restriction Agreement ("LURA"), the new HUD Use Agreement will mirror its requirements. For all other properties, the HUD Use Agreement will require (i) at least 30 percent of the units

to be reserved for residents earning no more than 80 percent of Area Median Income (AMI), or (ii) current affordability provisions on the project to continue, if more restrictive (iii). These rents will be the initial basis for cash flow analysis. The new HUD Use Agreement will have a term of 20 years, which may exceed the remaining term of an existing LURA. As noted above, the HUD Use Agreement will reflect the requirements of the original LURA, and its requirements will remain in effect under the HUD Use Agreement even if the term of the original LURA lapses prior to the end of the new 20-year term.

8.2.6 PROPOSAL SUBMITTED BY THE OWNER

Prior to submission of a formal Application, the Applicant should have discussed the property's financial difficulties with the Account Executive or Resolution Specialist. The proposal must be submitted within 60 calendar days of default. When in default or facing long term difficulty paying a project's debt service, the Owner must provide MAR to the Multifamily Regional Center or Satellite Office at least until such time as the PPC has closed, or later as required by the PPC Terms and Conditions. The Multifamily Regional Center or Satellite Office should not approve any Extensions of Election to Assign for a full claim unless a complete application package, as detailed below, has been received by the Multifamily Regional Center or Satellite Office.

A. Application

The Application must include the following:

1) A cover letter stating the parameters and conditions of the request. The Owner must provide:

a) The amount of a recast first loan that is supportable by cash flow;

b) An anticipated closing date, generally within four months from the date of the request;

c) A thorough discussion of the operational, economic, physical, and financial problems that caused the default;

d) Specific steps that have been taken to overcome both past and present problem(s), such as development and implementation of a new marketing or tenant retention strategy, revised lease up procedures, and/or measures to control expenses, along with an assessment of their effectiveness;

e) If the project has received a less than "Satisfactory" rating in any section of the Management and Occupancy Review ("MOR") or any deficiencies on the last HUD Physical Inspection, the Owner must provide written comments regarding the status of any corrective action. These should indicate what repairs have been completed, what other corrective actions

have been taken, and target dates for completing all remaining actions. If a MOR has not been performed within the last 12 months, the Multifamily Regional Center or Satellite Office must conduct a review prior to submission of the Application. (Note: Copies of reports and Owner's responses should be provided as well);

f) A discussion of how the PPC request meets all of the Regulatory and Threshold requirements outlined above; and

g) Discussion regarding the availability of additional financial support that will be utilized for the project, such as guarantees, letters of credit, etc.

2) Additional information to support the PPC request, including but not limited to letters reflecting local support, how the property is providing or will provide good quality and needed affordable housing, and any other related information.

3) If any part of the Application requires a waiver to the provisions of any handbook or regulation, a discussion of the need for the waiver and why it is in HUD's best interest to approve the waiver.

4) Certified rent rolls for the three months immediately prior to the month of application showing units and commercial space occupied and rents charged. Copies of all commercial leases must be submitted.

5) Last twelve months of occupancy statistics including physical and economic vacancy rates.

6) Written summary of current concessions being offered at the property for the last 24 months.

7) Management agent's most current market assessment and marketing plan.

8) A statement regarding Owner's Net Equity Contributions, defined as contributions or advances by the Owner, less repayments to the Owner. Owner contributions must have been in the form of cash, however for non-profit organizations the value of in-kind services may be considered. Accrued but unpaid IOI expenditures (for management, ground leases, or similar costs) generally may not be considered unless requested and approved by the Multifamily Regional Center or Satellite Office in advance of the transaction closing, in which case these fees must be converted to a note and future (post-PPC closing) fees must be treated similarly for years in which surplus cash is negative. A certified statement by an independent public accountant or a certified public accountant must be provided to verify these amounts, showing all advances and repayments to the Owner. Funds deposited due to calls on Letters of Credit shall not count as Owner contributions. Equity contributions and funds derived from operating

guaranties and similar financial commitments are generally not included in the calculation of Net Equity. HUD includes in the Net Equity Calculation only funds that were not committed prior to final endorsement. Accordingly, investor scheduled installment payments and payments resulting from cash flow and other guaranties, even if these payments occur after final endorsement, will not be included in the five percent equity contribution because they will have been committed to in advance of final endorsement. The analysis should verify that the contributions are actually new funds from the Owner and not (re)deposited project funds, and that all contributions were made after final endorsement. This statement should include, but is not limited, to the following:

a) Contributions/advances made by the Owner to the project accounts after final endorsement (excluding equity installment payments committed to by investors prior to final endorsement);

b) Distributions and repayments made to the Owner from the project accounts after final endorsement; and

c) The total net contributions comprised of the total of the contributions less distributions and repayments to the Owner.

9) Partnership or Limited Liability Corporation agreements and any guarantee or similar documents and a certification stating that all future equity installments, guarantees or similar resource commitments to the project have been disclosed, and describing the current status of all outstanding equity installments and guaranties or similar resource commitments.

10) Copies of the current year's budget and budget variances year-to-date, most recent unaudited interim balance sheet and income and loss statement, and the last three fiscal years' audited financial statements. These statements must also be used by the Owner to develop and provide projections for 10-year post-PPC closing. Projections should detail trending assumptions, and any changes in operations that result in deviations from historical results should be noted and justified.

11) A written narrative concerning the property's condition and the adequacy of the replacement reserve.

12) A Comprehensive Needs Assessment ("CNA") completed by an independent third party contractor using HUD guidelines, if any of the following conditions apply:

a) The property has replacement reserves of less than $250/unit at the time of the Application; or

b) No CNA has been completed within the 10 years prior to the date of the applicant's request; or

c) The property has a Real Estate Assessment Center ("REAC") physical inspection score below 60 points. Under this requirement only, a CNA can be waived by the Multifamily Regional Center or Satellite Office prior to submission of the Application. The Multifamily Regional Center or Satellite Office will consider the specific deductions in the REAC report and results from any site visits by HUD or Performance-Based Contract Administrator staff in determining whether a CNA is necessary.

Note: If a CNA dated no more than five years prior to the date of the Applicant's request is available, it may be updated and substituted for a new CNA required under the conditions described above.

13) If no CNA is required, then the Applicant must deliver a 20-year replacement reserve study ("Reserve Study") demonstrating that current Reserve for Replacement ("R4R") funds, in conjunction with ongoing annual R4R contributions, are adequate to fund the project's future physical needs. This study must include useful life and the anticipated timing and cost of replacement of all interior and exterior building elements, mechanical systems, and unit components, as well as any exterior grounds needs, in a format acceptable the Multifamily Regional Center or Satellite Office.

14) A recent (within the past 12 months) market study.

15) A statement that the Owner and all lien holders agree to accept a Use Agreement that will be superior to all liens, including the recast first mortgage. The Use Agreement will have a maturity of 20 years from the date of the PPC closing. The Use Agreement will also specifically state that the property cannot discriminate against Section 8 voucher holders.

If the property is already covered under a LURA, the HUD Use Agreement will mirror the LURA requirements.

For all other properties, the HUD Use Agreement will require (i) at least 30 percent of the units to be reserved for residents with incomes at or below 80 percent of Adjusted Median Income (AMI), at rents not to exceed 30 percent of 80 percent of AMI, or (ii)current affordability provisions on the project to continue, if more restrictive than in (i). Owners may request a lower percentage of units (not less than 10 percent) and/or higher percentage of AMI than 80 percent, but they must justify the requested modification through comparative modeling, market studies reflecting demand for affordable housing, current tenancy, and property support through Owner contributions.

16) Disclosure of the project names, FHA insurance numbers, and a narrative summary of current performance of any other formerly or currently FHA-

insured properties that 1) have had prior PPCs, Modifications or Restructurings, and 2) are owned by any principals of the Owner or their affiliates.

17) A completed "Draft Partial Payment of Claim Model" demonstrating the terms of the Applicant's proposed PPC, including the project's operating budget, long-term cash flow pro forma, and other relevant financial information.

18) Response to the latest MOR and Physical Inspection Report. If the project received a less than satisfactory rating in any section of the management review or any deficiencies on the last HUD physical inspection, the Owner must provide written comments regarding the status of any corrective action in progress, that is, what repairs have been completed, what other corrective actions have been taken, and target dates for completing these actions.

19) Any additional information that may be requested by HUD during the course of the review of the Application.

8.2.7 MULTIFAMILY REGIONAL CENTER OR SATELLITE OFFICE AND HEADQUARTERS REVIEW

A. Multifamily Regional Center or Satellite Office Analysis

HUD's review of a PPC request takes place in two phases: The first is carried out by the Multifamily Regional Center or Satellite Office overseeing the project in question, and the second by OAMPO.

B. Multifamily Regional Office or Satellite Office

The Multifamily Regional Office or Satellite Office will perform the following steps:

1) Screen the Application to make sure it is complete and meets the Regulatory and Threshold requirements listed above. This will be performed within five days of receipt of the Application. If incomplete, the Application must immediately be returned to the Applicant notating the deficiencies in writing. If the Application is complete, begin the review process immediately;

2) Verify project eligibility;

3) Review MAR to determine if all net cash is being remitted to the mortgagee. Staff must analyze MAR for consistency with the Owner's projections for income and expenses and to ensure that funds are spent only on reasonable and necessary operating expenses;

4) Review the Draft Partial Payment of Claim Model, financial statements including budgets and projections, Owner contributions, and any Physical Needs Assessments to determine if supplemental or additional information is needed, over and above the minimum requirements. If the PPC Model has

not been completed, the Multifamily Regional Office or Satellite Office will ensure that the HUD Historical and Base Workbook tab is completed. Once completed, the Multifamily Regional Office or Satellite Office should verify that the projections under Multifamily Regional Office or Satellite Office Adjusted Base column are reasonable. Revise if deemed necessary;

5) Review Active Partner Performance System (APPS) for any past or present flags on the Owner or management company;

6) Analyze available MOR. If a MOR has not been conducted within the last 12 months, a site visit by Multifamily Regional Office or Satellite Office Account Executive or Resolution Specialist to review project operations must be completed. Separate paragraphs covering Owner and management agent capacity should be prepared. The OAMPO generally does not recommend approval contingent on changing the management agent since the lack of a change prior to submission of the Application negatively reflects on Ownership. A change in the management agent may impact the stability of income and/or expenses, perhaps positively, but potentially negatively;

7) Advise the OAMPO and help to coordinate the work of the Applicant, as needed throughout the review process;

8) Track, approve, or reject, and notify the OAMPO of all extensions of Election to Assign the Mortgage; and

9) Provide a detailed cover memorandum from the respective Multifamily Regional Director or Satellite Office Director to the Director, Office of Asset Management and Portfolio Oversight with the following information:

a) A statement that the Multifamily Regional Office or Satellite Office has determined that the proposed transaction is the best strategy for the property, based on its knowledge of the project, the market, and any other strategies that might be available;

b) A confirmation that project reserves are adequate based on the CNA or Reserve Study supplied by the Applicant. If reserves are not adequate, the Multifamily Regional Office or Satellite Office will work with the Owner to develop an agreement establishing appropriate one-time reserve contributions in conjunction with the PPC as well as adjustment to annual reserve deposits if necessary;

c) A determination that the Owner and management agent have the capability to resolve current and future problems, through review of the Owner's discussion of the problems that led to the need for a workout, and steps taken to overcome both past and present problem(s). The analysis must include a review of HUD files and systems to validate that the problems were beyond the control of the Owner. This written analysis

must be included in the Application. This analysis must be separate from the analysis and determinations prepared by the Owner;

d) Confirmation that all Regulatory and Threshold requirements have been met;

e) Provision of any other special information or circumstances pertaining to need for the housing, preservation worthiness, etc., that should be considered and might not otherwise be identified in the course of the OAMPO review; and

f) A written statement of support of the Application by the Multifamily Regional Center or Satellite Office.

The assigned Multifamily Regional Office or Satellite Office reviewer and OAMPO underwriter must coordinate information from a number of sources and systems within HUD. This includes the Multifamily Regional Office or Satellite Office, Account Executive, Resolution Specialist, staff appraisers, Economic and Market Analysis ("EMAS") reports, the Online Property Integrated Information Suite ("OPIIS"), the Multifamily Delinquency and Default Reporting ("MDDR") system, and the Active Partner Performance System ("APPS").

The Multifamily Regional Office or Satellite Office will have 30 calendar days from the receipt of the Application to complete their analysis. If additional information is needed, the Account Executive or Resolution Specialist must immediately notify the applicant in writing of the additional information needed and place the request on hold until the information is provided. The loan should be maintained in a rolling default status until all information is received and HUD has completed their review and if applicable, the Applicant has responded. Failure to keep the rolling default status will result in direction to the servicer to process the full claim. If the Owner is unable to keep the loan in a rolling default status, the Multifamily Regional Office or Satellite Office should contact the OAMPO before directing the servicer to process the full claim. Once a complete Application is received and accepted and the analysis has been completed, forward the entire Application package and the cover memorandum to the OAMPO Director for review and processing.

The Multifamily Regional or Satellite Office Director is authorized to reject any Application that is not prepared consistent with the requirements of this Chapter. Therefore, if the Application does not meet these requirements, the Multifamily Regional Center or Satellite Director will send a registered rejection letter to the mortgagor and mortgagee explaining why the Application was rejected. The Applicant has 15 calendar days from date of the rejection letter to provide additional information to the Multifamily Regional Center or Satellite Director and request reconsideration of the Application. If the Application is again rejected, the Applicant has five business days from the date of the rejection

letter to submit an appeal to the OAMPO. The Multifamily Regional Center or Satellite Director will send a registered rejection letter to the mortgagor and mortgagee explaining why the Application was again rejected and explaining the appeal process. The appeal to OAMPO must address the reasons for the rejection and the mitigating factors that exist for continuing a review of the request by the Multifamily Regional Center Office or Satellite Office. After any appeals period has expired, the mortgagee will be instructed by the Multifamily Regional Center or Satellite Director to process a full claim, if the loan is not reinstated.

C. The Office of Asset Management and Portfolio Oversight: Multifamily Asset Management and Counterparty Oversight Division

The Multifamily Asset Management and Counterparty Oversight Division will perform the following initial review steps upon receipt of the Application from the Multifamily Regional Center or Satellite Office:

1) Identify comparable properties near the project and collect relevant peer information along with a brief narrative analysis as to market comparability of the chosen projects with the Applicant's project;

2) Analyze the balance in the replacement reserves account, taking into consideration any suspension of deposits, age of the property and physical inspection reports to ensure that at closing of the PPC, the replacement reserve account is adequate and that future monthly deposits will be sufficient for the property's needs; and

3) Review and analyze the CNA and provide a brief analysis concerning the acceptability of the proposed repair requirements.

To effectively perform the above review responsibilities, the following documents, if available, should be consulted to support the PPC and the Multifamily Regional Center or Satellite Office recommendation for approval:

- Market Study;
- The latest MOR;
- REAC Inspection Report; and
- Latest CNA.

The Multifamily Asset Management and Counterparty Oversight Division will have 15 calendar days upon receipt of the Application from the Multifamily regional or Satellite Office to complete their review of the documents listed above. If there are any discrepancies, missing items, or further explanations needed, the Multifamily Asset Management and Counterparty Oversight Division will work with the Multifamily Regional Center or Satellite Office to resolve the items.

D. Multifamily Asset Management and Counterparty Oversight Division Processing

The Multifamily Asset Management and Counterparty Oversight Division's role is to provide the full analysis and underwriting necessary to achieve a balanced assessment of the long-term impact of the proposed transaction on the project, factoring in the cost to the FHA General Insurance Fund and various other considerations. Multifamily Asset Management and Counterparty Oversight Division will have 30 days from receipt of the complete Application from the Multifamily Regional Center or Satellite Office to complete the review and analysis of the Application set forth below:

1) Verify the Owner's contributions by reviewing the project's financial statements.

2) Contributions must be shown on the Statement of Cash Flows. The analysis should verify that the contributions are actually from the Owner and not (re)deposit of project funds, and that all contributions were made after final endorsement. Funds deposited due to calls on Letters of Credit shall not count as Owner contributions. The Owner's contribution ratio must equal or exceed five percent of the original loan amount. The contribution ratio is calculated by dividing the net capital contributions by the original loan amount of the insured loan; and

3) Analyze the Draft Partial Payment of Claim Model. The Draft Partial Payment of Claim Model will be used to determine the base year (first full year after PPC closing) Net Operating Income ("NOI"). OAMPO will review the project's income, expenses, vacancy rate, and NOI submitted by the Owner and make adjustments where necessary. The following categories must be discussed by the Applicant on any Application to OAMPO:

a) Income: Besides rent, other sources of income and adjustments must be reviewed. This may include, but is not limited to, parking, commercial space, laundry, tenant charges and historical bad debt. The impact of the proposed use restriction should be examined.

b) Economic vacancy rate: This is verified by reviewing the current rent roll and comparing these rents with the approved rent schedule. The economic vacancy rate takes into consideration the concessions and rent reductions that the Owner may have used to increase the physical occupancy of the project. Because of concessions like these, the project may have a reasonable level of units occupied, but the income may be insufficient to pay all expenses and debt service. The economic vacancy should show a flat to decreasing trend over the last six months.

c) Expenses: These are determined by reviewing historical data (annual and interim), current year budgets and post-closing projections. This process is

similar to the review of an Owner's request for a budget-based rent increase.

The Draft Partial Payment of Claim Model will calculate a supportable first loan. In making the calculations, the interest rate on the recast loan must be 125 basis points over the current 10-year Treasury Rate (rounded to the nearest tenth.) A minimum Debt Service Coverage Ratio ("DSCR") including Mortgage Insurance Premium ("MIP") of 1.20 is required for the base year. If projections reflect that the DSCR in future years will fall below 1.20, a Letter of Credit ("LOC") or similar assurance is required to cover projected cash flow deficiencies.

If the supportable first loan is less than 50 percent of the Unpaid Principal Balance ("UPB"), and no waiver is granted, the Owner should be contacted and offered an opportunity to increase the Owner contribution. (If the 50 percent test is not met solely due to an increase in interest rates since submission of the Application, no additional Owner contribution will be required.) The additional Owner contribution required will be the current UPB divided by 2, minus the supportable first mortgage. The Owner must respond and agree in writing within five business days of receipt of the offer, otherwise, the PPC must be rejected.

The model will calculate the amount of the PPC second loan. HUD will include in the second loan all interest owing at the current First Mortgage Note Rate (less any additional contributions required to achieve the five percent contribution requirement). All fees and late charges must be waived by the mortgagee. The PPC second note will have a maturity date equal to the first loan be callable at maturity of the Use Agreement, have an interest rate equal to the Adjusted Federal Rate for the month of closing, and require payments equal to 75 percent of surplus cash annually after filing of the annual financial statement.

The most recent version of the PPC model is available below:

PPC BETA MODEL
12.15.16. updated d

Owners or their representatives may utilize the model, but the OAMPO must rename the Owner's model and make changes as appropriate. A discussion of any differences from the Owner's Application must be noted within the model or separate write-up. The model will be modified to reflect that day's first mortgage interest rate (125 bp over the 10-year Treasury rate).

4) Analyze past performance of the property and compare expense results to peer properties using OPIIS or similar information. Significant unexplained deviations from peer properties may indicate a property in which the default may have occurred in part due to Ownership actions and not be appropriate

for a PPC. Consultation with staff appraisers and other HUD development staff should be part of this analysis step.

5) Prepare a summary memorandum to the PPC Committee (defined in 8.2.7 E below). OAMPO and the PPC Committee will be provided the summary memo, the Multifamily Regional Center Director memorandum recommending approval, and the PPC model for review. The PPC Committee may request additional information, as needed.

6) Request from the Multifamily Regional Center or Satellite Office any additional information deemed necessary to determine the viability of the PPC.

E. Offer, Approval, Rejection, and Appeals

It will be the OAMPO's responsibility to prepare recommendations for all Applications when underwriting is complete, using the process outlined below. Projects that do not meet fundamental regulatory or threshold requirements as well as those without complete Applications will not be fully reviewed or presented to the PPC Committee (the "Committee"). The OAMPO and/or Committee will proceed with its review as follows:

1) The Committee will be comprised of 1) the Director of OAMPO; 2) the Director of Multifamily Asset Management and Counterparty Oversight Division; and 3) the respective Multifamily Regional Office or Satellite Office Director, Multifamily Regional Center Office or Satellite Office Account Executive or Resolution Specialist, and the assigned OAMPO Underwriter assigned to the PPC. The Committee will review and make a determination with respect to all of the eligible and complete Applications submitted within thirty days.

2) Voting members of the Committee will consist of the Director of OAMPO, the Director of Multifamily Asset Management and Counterparty Oversight Division and the Multifamily Regional Center Office or Satellite Office Director. A quorum of three is required for any decision.

3) When projects are ready for Committee review, the PPC Underwriter will schedule a meeting to present recommendations and financial analyses, along with a final Draft PPC Model, a narrative summary and a Term Sheet for distribution to the Committee members in advance of the meeting. The Term Sheet will describe all of the conditions under which a PPC could be approved and it will specifically address the risks of the transaction and how such risks are to be mitigated.

4) The Committee will review the staff's analysis and authorize staff to issue the Term Sheet with the following clauses to the Applicant if the proposed PPC is acceptable to the Committee. Any changes/revisions to the Term Sheet must be approved by the Director, OAMPO. It is as follows:

a) The original First Note will be adjusted to reflect:

i) A principal balance reduced as a result of a PPC;

ii) A maximum interest rate of 125 basis points over the 10-year Treasury Rate (rounded up to the nearest fifth or tenth) at the time of HUD's approval. This rate must be a fixed rate and the loan must fully amortize over its term;

iii) The original maturity date or a new maturity date as specified in the Offer or Approval;

iv) Monthly payments and a new amortization schedule based on a. through iii. above;

v) If requested by the mortgagee, the First Mortgage Note may include a restriction on prepayment for the purpose of enhancing the marketability of the new GNMA Mortgage-Backed Security. Any prepayment restriction must be prepared in accordance with Mortgagee Letter 87-9;

vi) If the mortgage servicer is unable to offer or place a recast first loan with a GNMA investor at the rate approved above, HUD may consider a modification to the rate and size of the loan. To obtain a higher rate, the mortgage servicer must certify to the Director of OAMPO, HUD Headquarters, that it has made its best efforts to place the loan at the approved rate. As part of this certification, it further certifies that it has provided the secondary market the following terms:

1. Minimum DSC including MIP and deposits to the replacement reserves of 1.20 for PPC;

2. Inclusion of lockout and prepayment penalty;

3. 20-year call provision;

4. 20-year Use Agreement;

5. Owner's pledge that no IOI payments will be paid from project cash flow in years of deficit surplus cash;

6. Cash flow dependent upon the model's underwritten economic vacancy percentage for the base year;

7. A minimum of three rate bids from major parties that will result in the placement of the recast mortgage in a REMIC transaction; and

8. Certification that documentation of information provided to investors will be retained for three years for HUD review at the servicer's office. If in compliance, proprietary information will not be copied or retained by HUD.

NOTE: If requested, HUD will make available its approved underwriting model to the mortgage servicer after the decision process and all appeal opportunities are concluded.

NOTE: If a certification containing the conditions above is received from the mortgage servicer, HUD will allow the rate to increase by up to 50 basis points without further HUD approval.

The Owner may not incur additional debt without the prior written consent of HUD and the FHA-insured mortgagee. The PPC note holder (subject to the rights of the FHA-insured mortgagee) has the right to foreclose on its security interest, perfected by filing of a UCC-1 Financing Statement, in the event of a default on the PPC Note.

In the event the first loan is prepaid and there is no additional debt with FHA mortgage insurance, the Owner will furnish HUD and the PPC Note holder with audited annual financial statements;

b) The terms of the second (PPC) Note will be as follows:

i) Owner and mortgagee consent to a second, HUD-held loan secured by a mortgage;

ii) An interest rate equal to the AFR for the month of closing;

iii) Maturity date coterminous with that of the first loan;

iv) A "due-on-sale, refinance, or termination" provision;

v) As long as the PPC Note is held by HUD, a service charge calculated at one half (0.5) percent annually based on the unpaid principal balance of the PPC Note must be paid to HUD monthly from project funds prior to the surplus cash flow split calculation;

vi) The annual payment on the PPC Note, if surplus cash is available, will be 75 percent of annual surplus cash as specified in the PPC Regulatory Agreement between the Secretary of Housing and Urban Development and the project Owner, together with other

applicable HUD Regulations and administrative requirements. The surplus cash payment on the PPC Note is due within 10 calendar days of the required filing of the Annual Financial Statement. Owner's share shall be 25 percent of surplus cash and is only payable to Owner concurrently with payments on the PPC Note. The annual payment on the PPC Note will be applied towards interest first, and then principal;

vii) A call provision on the maturity date of the Use Agreement, at which time HUD, or the PPC Note holder, at its sole option, may require the full payment of the debt, or provide the Owner the opportunity to propose a restructuring of the debt; and

viii) Language prohibiting successors and assigns of the beneficiary of the PPC Note from imposing property insurance requirements that exceed the original principal balance contained in the first mortgage or deed of trust note, or are in addition to those required by the first deed of trust note holder or first mortgage note holder so long as the First Mortgage Note is held or insured by the Secretary of HUD.

c) Other Terms and Conditions of the PPC Transaction:

i) If IOI expenditures have been included as an Owner's contribution in calculating eligibility for a PPC, then a requirement that those expenditures cannot be taken or must be re-deposited for any year in which surplus cash is negative (not to exceed the amount of the negative surplus cash amount) will be imposed. The redeposit or accrual can only be repaid from the Owner's share of surplus cash in future years;

ii) The monthly deposit to the Reserve for Replacement Account ("RFR") will resume with the first payment of the recast first mortgage. (Previous deposits will not have to be made up, unless the reserve balance has been determined to be inadequate.);

iii) As long as the PPC Note is outstanding, all eligible RFR expenses must be paid through the RFR account and invoices must be submitted for reimbursement during the calendar year in which the work was completed;

iv) All escrows, such as taxes, hazard insurance and MIP shall be funded at closing;

v) All IOI payables older than 30 calendar days must be converted to notes payable and can only be repaid from the Owner's share of surplus cash or paid by the Owner prior to closing;

vi) All other payables (i.e. non-IOI payables) are to be cleared at closing by the Project Manager;

vii) Under no circumstances may changes be made to the documents reviewed other than to conform to the terms and conditions of the approval, without HUD's specific authorization. The Regional Center or Satellite Office Counsel, or Headquarters' Office of General Counsel, may modify the documents to conform to local legal requirements;

viii) If the FHA-insured first loan is repaid, the Owner must establish and maintain continued funding of all escrows required by the first mortgage until the PPC Note is repaid in full;

ix) If at any time during the term of the PPC Loan, HUD determines that there has been an uncorrected material violation of a Regulatory Agreement, Housing Assistance Payments Contract, HUD Use Agreement, or any other contractual or regulatory provision governing the operations of the project, the interest rate on the PPC Note will revert to the rate of the original first mortgage loan in effect prior to the PPC, if a notice and a right to cure have been provided to Owner;

x) Project operating income may not be used to pay financing fees, attorney fees, consultant fees, other professional fees, or any other costs of the restructuring transaction. The Owner's share of future surplus cash may be used for these purposes only if available for distribution in accordance with HUD regulatory requirements and applicable policy guidelines;

xi) Cash held in suspense by the mortgagee will be allowed by HUD to be used at closing to pay reasonable closing attorney fees, title and recording fees, escrow shortages and interest for the remainder of the closing month. The PPC Note will not be increased if project cash is insufficient to cover these costs;

xii) HUD will include the interest computed since the date of delinquency in the PPC Note amount, based on the actual number of days in a 365 or 366-day year. The mortgagee cannot collect more interest from the project than the amount paid by HUD. Late fees accrued since the last payment or any other costs to close cannot be included in the transaction or paid by the project in the future;

xiii) The Sources and Uses of Funds Statement for any of the Applications may not show disbursements of funds to the Owner;

xiv) No funds may be paid at closing to identity-of-interest persons or entities. The Sources and Uses of Funds Statement must also be signed and certified by the Owner or representative; and

xv) The Owner and the servicer/mortgagee of the first mortgage loan must provide notices and documentation to the PPC Note holder upon the occurrence of events that could materially affect the value and position of the PPC loan such as full or partial payment of principal on the first mortgage loan, events of default on the first mortgage loan, declaration of bankruptcy by the Owner, and any documentation related to a bankruptcy or any foreclosure action.

5) Approval of Application. When the Owner accepts the Term Sheet and the mortgagee submits the Election to Assign in the MDDR System, the Director of OAMPO will sign a formal Acceptance Letter reflecting the Terms and Conditions of the Term Sheet, to be sent to the Owner and Mortgagee. At the same time, the Draft PPC model will be adjusted to reflect that day's first mortgage interest rate (125 basis points over the 10-year Treasury rate) for underwriting purposes. The interest rate will be determined in the month in which the loan is closed. The Owner and Mortgagee are required to counter-sign the Acceptance Letter and return it to the Director of OAMPO.

6) If the Application does not meet the requirements, the Director of OAMPO will send a Certified Letter/Return Receipt Requested to the Applicant notifying the Owner and mortgagee of the reasons for HUD's decision.

7) When the Application is rejected by the Committee, the Applicant may request an Administrative Review of the decision.

a) This request must be received by the Administrative Appeals Officer ("AAO") within 10 calendar days of the Applicant's receipt of OAMPO's letter rejecting the transaction. It must be made in writing and it must clearly state the reasons for the Owner's objection to the decision. It may also contain any additional information in support of the objections that the Applicant wishes to be considered.

b) The scope of Administrative Review will be limited to a determination of whether the Committee's decision is:

i) Reasonable in light of the facts and circumstances, including any information provided by the Applicant with its request for Administrative Review; and

ii) In accordance with all applicable statutes and regulations.

c) Within 15 calendar days after receipt of the Owner's request to the AAO, the AAO shall issue a decision (the "AAO Decision"). The AAO Decision will be in writing and specifically address the objections raised by the Owner.

The AAO Decision is final. After any Administrative Review period has expired and if the mortgage is not reinstated, the mortgagee will be instructed by the Multifamily Regional Center or Satellite Office Director to process a full claim for FHA mortgage insurance benefits.

d) Owner's Acceptance of PPC Terms. Acceptance of OAMPO's PPC terms is verified through the Owner's signature on the Term Sheet and the mortgagee's submission of an Election to Assign the mortgage to FHA. However, the Election to Assign will be suspended in MDDR until such time as closing is virtually certain, since once it is accepted, the PPC must be closed or the mortgage assigned within 30 calendar days. (Two 30 day extensions of this initial 30-day period are allowed if necessary, but if closing does not occur within 90 calendar days of FHA's acceptance of the mortgagee's Election to Assign, the mortgagee must assign the loan to FHA.) To continue the process after 90 calendar days, OAMPO must obtain a regulatory waiver from the FHA Commissioner. Once the PPC is closed the first loan should be reinstated in the MDDR system.

e) Following the Owner's acceptance of PPC Terms, no further payments should be applied to the first loan. The mortgagee should continue to collect all net cash but maintain the funds in a suspense account.

f) If a PPC Term Sheet is accepted, GNMA will allow the transaction to proceed, regardless of the payment status.

8.2.8 CLOSING REQUIREMENTS FOR PARTIAL PAYMENT OF CLAIMS

A. Scheduling the Closing

HUD's offer letter from OAMPO will include a closing date agreed upon by OAMPO and the Office of General Counsel, Office of Insured Housing, Multifamily Mortgage Division in Headquarters ("OGC"). Authority to close a transaction terminates when the closing date passes, unless extended in writing prior thereto. If HUD agrees to an extension, an amendment to HUD's offer letter must be executed prior to expiration thereof. The amount of the claim payment will not include accrued interest past the date of HUD's original offer letter. HUD's offer letter must be signed and returned within the required time frame stated there. The closing process and requirements will be discussed in a kick-off and conference call(s) between OAMPO, HUD Multifamily Regional Office staff, Multifamily Claims staff, OGC attorney, the lender and lender's attorney, and the Owner and Owner's attorney.

HUD has the authority to set the closing date. The OAMPO will coordinate with OGC and Multifamily Claims Branch in Headquarters to provide a projected closing date which may be earlier than the targeted closing date in the offer letter. Since various offices within HUD are involved in the PPC transaction, closing should occur on schedule and proceed accordingly. Delays due to mortgagor/mortgagee or other party's action or inaction will be deemed the mortgagor's responsibility. The Owner is strongly encouraged to meet the targeted closing dates as delays may be costly. Once the amount of the PPC Note is determined, any increase in the funds required to close must be funded by the Owner at closing. For example, interest accruing after the original closing date cannot be added to the PPC unless the delay was caused by a HUD action or inaction. **The closing must occur within 60 days from the date of the PPC offer letter. Otherwise, HUD's offer of the PPC will be null and void.**

The OAMPO will collect all required documents from the Multifamily Regional Office or Satellite Office, Owner, and mortgagee. Upon receipt, the documents for all transactions will be reviewed for consistency under the approved Term Sheet and distributed to the appropriate staff within the OGC The documents will also be delivered to the Multifamily Claims Branch.

B. Required Legal Closing Documents and Review

At least 21 business days prior to the closing date, the initial draft legal documents must be submitted to OGC. At least 14 business days prior to the closing date, the final draft legal documents must be submitted to OGC. Last, at least 7 business days prior to closing, the execution legal documents must be submitted to OGC. Failure to submit the legal closing documents as instructed by OGC may delay the closing. Required legal documents must be submitted in a format acceptable to OGC. HUD will make copies of final loan documents for itself and for the Escrow Agent. HUD will not make copies for other parties or send documents to third parties. The Department only requires one copy of the legal documents for execution. Copies may be made from this set. The complexities of the PPC transactions may require additional documents, notwithstanding, the list of legal documents that are generally required includes, but is not limited to the following:

1) Modification of First Mortgage/Deed of Trust Note;

2) Modification of First Mortgage/Deed of Trust;

3) Modification of Security Agreement if there is an existing separate Security Agreement;

4) Second Mortgage/Deed of Trust Note;

5) Second Mortgage/Deed of Trust;

6) Second Security Agreement, if required;

7) Second Regulatory Agreement for PPC loan;

8) UCC Financing Statement Amendments (FHA-insured loan, as modified);

9) Endorsements to Existing Mortgagee Title Insurance Policy;

10) Commitment for Mortgagee Title Insurance Policy and a new Mortgagee Title Insurance Policy for the Second PPC loan;

11) Use Agreement;

12) Good Standing Certificate of Borrower;

13) Attorney's Certification of HUD: No Change to Documents;

14) UCC financing Statements (PPC loan);

15) Subordination of any additional liens;

16) Escrow Instruction Letter; and,

17) Other documents as instructed by OGC Attorney.

NOTE: Treasury Offset Program. If any parties or their agents or representatives (for example, the escrow agent or title insurance company) owe a delinquent debt to a federal governmental agency, that agency sends information about the debt to the Treasury Department's database. Before the Treasury Department wires PPC funding, the database is searched to see if the payee owes a delinquent debt. If the debt is in the database, the Bureau of Fiscal Services will offset (reduce or withhold) the federal payment (the PPC wire) to pay the debt, which may delay funding. HUD will not pay additional interest, if funding is delayed as a result of the Treasury Offset Program.

C. Multifamily Claims Branch Process (Concurrent with Legal Review)

The OAMPO or HUD's Multifamily Claims Branch will obtain the following documents (copies, unless otherwise noted), which must be obtained within 14 business days prior to the scheduled closing. Items 6-13 must be received 14 business days prior to closing. Please note that documents listed in items 1-5 below should be requested during the initial kick-off call:

1) The existing insured mortgage/deed of trust and promissory note (**obtained from the Lender)**;

2) The modification agreement/allonge (if any) (**obtained from the Lender)**;

3) The Original Closing Memo 290 (**obtained from the Lender)**;

4) The existing Regulatory Agreement (**obtained from the Lender**;

5) The existing LURA, if any;

6) HUD Form 2537 Mortgagee's Application for Partial Payment;

7) HUD Form 2747 Application for Insurance Benefits;

8) HUD Form 1044-D Payment Information Treasury Financial Communication System;

9) Payment Authorization to a third party (third party to complete 1004-D if appropriate);

10) Notice of Default (MDDR). The lender must enter the Notice of Default into the MDDR System. The OAMPO staff has the responsibility to accept the election and place it in a pending status. This is usually done at the time the HUD offer letter is signed;

11) Certification of Mortgage Balance signed by the Owner and the mortgagee;

12) Statement of Sources and Uses signed by the mortgagee and Owner; and

13) Any relevant waivers;

The total amount of a PPC will be determined by the Certification of Mortgage Balance (Certification) and certified Sources and Uses from the servicing mortgagee after the application of remaining net cash proceeds and all unapplied funds. The Certification should include all escrow balances and must be signed by the mortgagee and the Owner.

Working with the OAMPO, the Claims Branch will verify the current note's Unpaid Principle Balance (UPB) and calculate the mortgage interest owed from the date of the last payment to the date of closing. The Multifamily Claims Branch calculations are based on a 365 or 366 (leap year) day year, and this may cause disparities in the interest calculations of HUD and the mortgagee. Five calendar days prior to closing, the OAMPO Underwriter will provide to the Multifamily Claims Branch a Closing Memorandum detailing the application of the claim payment to interest and principal. As part of the Closing Memorandum, an executed Sources and Uses Statement and Certification of Mortgage Balance will be attached.

The delinquent Mortgage interest amount listed on the Certified Mortgage Balance, the Sources and Uses, and the OAMPO Closing Memorandum must be in agreement with the Claims Branch internal calculations.

Note: In addition to the above, the Claims Branch must receive the following:

14) A copy of the Approval Letter and the Terms and Conditions immediately upon Director, OAMPO approval/issuance;

15) Upon final completion of the PPC closing, OAMPO must submit to the Claims Branch a copy of the PPC Note; and

D. Closing Process

Prior to the closing date, all legal documents must be signed by the appropriate designated HUD official. This must be accomplished at least two days prior to closing. After HUD's official signs, the documents will be sent by the OAMPO to lender's counsel or escrow agent (generally a title company). On the morning of closing, the escrow agent will notify the OAMPO Underwriter that the documents are in their possession, the title company is open, and they are proceeding to the land records office to record documents specified in the Escrow Instruction Letter. Following approval from OGC to proceed, the OAMPO Closing Coordinator will notify the Claims Branch to trigger the wire transfer. The escrow agent will follow the Escrow Instruction Letter in the transaction as approved by OGC. OGC must be notified and consulted before wire transfer is triggered, to ensure that all legal requirement have been met. The OAMPO Closing Coordinator will collect the original signed and fully executed closing documents along with supporting documentation showing compliance with all terms and conditions for approval. Current practice is to require three electronic copies and one hard copy of the materials for the OAMPO. One of the electronic copies will go to OGC and the other electronic copy will go to OAMPO. The third electronic copy will be sent to the Multifamily Regional Center or Satellite Office. The hard copy will be kept by OAMPO.

8.2.9 SECTION 6. POST-CLOSING

A. Post-Closing Requirements

Multifamily Insurance Operations will receive a copy of the modified First Mortgage and modified First Note from the OAMPO Closing Coordinator. A copy of the modified first note and the original PPC will be sent to HUD's Loan Servicer. A copy of the second note must be forwarded to Multifamily Notes Servicing. Afterwards, the lender must go into the MDDR System and reinstate the loan. Closing Documents should come from the Escrow Agent within two weeks.

As soon as documents are available after closing, a copy of the PPC Note must be delivered by OAMPO to the Office of Multifamily Notes Servicing. A copy of the recast first note and mortgage must also be provided by OAMPO to the Office of Multifamily Insurance Operations, to ensure that MIP is properly

calculated post-closing. In addition, Multifamily Regional Center or Satellite Office staff should confirm removal of default flags after closing has occurred.

The fully executed closing documents, along with supporting documentation showing compliance with all the terms and conditions of approval must be submitted to the handling OGC. The closing documents and required certifications are to be submitted in the form prescribed by HUD Counsel and signed by the Owner's counsel, as appropriate.

As long as the PPC Note is held by HUD, the OAMPO will work with the Account Executive or Resolution Specialist to compare the Annual Financial Statement submitted by the Owner to the final HUD-approved baseline and 10-year projections. Significant deviations should be investigated to ensure all income and expenses, reserves and accounts payable are properly accounted for and that surplus cash is accurate. An example of an improper practice would be running the cost of a replacement reserve item through expenses, rather than requesting a withdrawal from the reserve. This will have the effect of inflating expenses and reducing surplus cash, of which 75 percent must be paid on the second mortgage. Expenses should also be closely examined to ensure that no expenses related to the PPC have been incurred, as these are disallowed. All accounting, legal, and consultant fees must be paid for by the Owner and not out of project accounts. After completion of the financial statement analysis, the Account Executive or Resolution Specialist is required to summarize the analysis in iREMS. This must be completed annually as long as HUD is the holder of the PPC Note. The Account Executive or Resolution Specialist should follow established protocol to ensure filing of accurate financial statements and that required payments are made on the PPC Note.

Multifamily Regional Centers and Satellite Offices staff must perform on-site reviews of all properties which have received PPC annually. The on-site review will be to determine if the owner is in compliance with the use agreement restrictions for affordable set-aside units as a condition of the PPC. If findings of noncompliance are found, the Multifamily Regional Center or Satellite Office staff reviewer must document these findings in writing to the owner. The owner must submit a Plan of Action to address any areas of noncompliance within 30 days. If the on-site review cannot be completed due to distance or lack of travel funds, a desk audit may be completed. The reviewer must request a current rent roll from the management agent. From that rent roll, the reviewer must review at least five files, plus one for each 10 units over 50 for compliance with the PPC use restrictions.

The on-site reviews shall continue for the term of each property's Use Agreement. An e-mail from the Multifamily Regional Center Directors will be sent to the Director, OAMPO certifying that the required on-site reviews have been performed and closed satisfactorily.

The Multifamily Regional Centers and Satellite Offices must prepare annually, a report detailing properties with active Partial Payment of Claims (PPC), status of receipt of annual owner certification, status of review of certifications, and any issues from those reviews. This report would be provided to the appropriate Multifamily Regional Center Directors within 60 days of the property's fiscal year closing.

An e-mail from the Multifamily Regional Center Directors will be sent to the Director, OAMPO certifying that all the required annual owner certifications have been entered into iREMS. Additionally, a snapshot of the iREMS Use Restriction List updated screen must be provided for each property with a PPC. Documentation should be provided to the OAMPO within 90 days of project's fiscal year closing.

B. Subordination and Assumption

All PPC cash flow mortgages contain a due on sale, refinance, or termination clause, very similar to a clause that is required in notes restructured by the Office of Recapitalization. Housing Notice 2012-10 Titled: Guidelines for Assumption, Subordination, or Assignment of Mark-to-Market (M2M) Loans in Transfer of Physical Assets (TPA) and Refinance Transactions (the "Notice") is the specific guidance for these transactions. OAMPO will follow a similar process for approving any request for subordination and assumption of a PPC cash flow mortgage note. The Notice and any subsequent updates will provide guidelines for analysis. Approval authority for any request for a Subordination and/or Assumption of PPC cash flow mortgages is as follows:

1) The Multifamily Regional Center has authority to review and approve a waiver of the "due on sale" requirement for PPC involving a transfer of a property or of interests in the ownership of a property (TPA), as long as there are

   a) No proceeds to the seller and/or purchaser; and

   b) No modifications to the existing first mortgage,

2) The Multifamily Regional Center has authority to review and approve a waiver of the "due on refinance" requirement for PPC transactions in which the present Owner seeks to refinance an existing first mortgage, as long as:

   a) There are no Proceeds to the Owner;

   b) The new first mortgage is FHA-insured;

   c) The debt service payment is not increased;

   d) The first mortgage unpaid principal balance is not increased; and

e) There are no changes to property ownership at any level.

Any request not meeting the criteria above must be forwarded from the Multifamily Regional Center to the OAMPO in Headquarters. HUD will also not approve any changes to the rate or maturity of the PPC mortgages. These terms were negotiated at the time of the PPC Closing and must not be changed.