

Legal Opinion: CIM-119
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Subject: Applicability of NHA Section 250 to
Portfolio Reengineering Demonstration

May 3, 2000

MEMORANDUM FOR: Kevin L. McNeely, Director,
Portfolio Reengineering Demonstration, H

FROM: John J. Daly, Associate General Counsel
for Insured Housing, CI

SUBJECT: Applicability of NHA Section 250 to Portfolio
Reengineering Demonstration

You have asked for our advice on the issue of whether prepayments made by, or on behalf of, project owners participating in the FY 1997 and the FY 1998 Portfolio Reengineering Demonstration programs (the PRE Demonstration Programs)¹ are subject to the limitations on prepayment of mortgages that are set out in Section 250 of the National Housing Act (NHA) or are subject to the conditions for prepayment contained in Section 219(b) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, P.L. 105-276, (FY 1999 HUD Appropriations Act). Section 250 is applicable to any mortgagor's "offer to prepay" during such time as the terms of a Note require the mortgagor to obtain the approval of the Secretary in order to prepay. The universe of insured project mortgages subject to Section 250 are those which have entered into rent supplement contracts or accepted flexible subsidy assistance, projects with nonprofit mortgagors, and projects with limited distribution mortgagor entities that are within the first twenty year period after insurance endorsement.

The Joint Explanatory Statement in the Conference Report (H.R. Conf. Rep. No. 104-812 at 62 (1996)) accompanying the FY 1997 HUD Appropriations Act states:

The importance of carrying out this demonstration

¹ The Pre Demonstration Programs were authorized, respectively, by Section 212 of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1997, P.L. 104-204, (FY 1997 HUD Appropriations Act), as extended and amended by Section 522(b) of the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1998, P.L. 105-65, (FY 1998 HUD Appropriations Act).

effectively cannot be overstated in light of the families the projects serve. Many of the properties are home to elderly and disabled families, and may be located in high-cost rental markets with little available, affordable housing or are in rural areas with scarce housing resources. In most cases, the projects are oversubsidized and are in danger of defaulting on their mortgage if the section 8 payments are reduced to market levels, raising concerns of owner disinvestment, resident displacement, and government ownership, management and disposition of the housing inventory. To achieve deficit reduction and a balance (sic) budget, continuing the existing subsidy arrangements is simply not an option.

This statement makes clear that, for budgetary reasons, Congress determined that "continuing the existing subsidy arrangement is simply not an option." The statement also indicates that Congress was aware that the assisted/subsidized housing projects, which are most likely to default on their mortgage loans when a project's Section 8 contract rents are reduced to market, fall within the universe of affordable housing projects subject to NHA Section 250.

Section 212(h)(1) of the FY 1997 HUD Appropriations Act requires the Secretary to take at least one of the specified actions set out in subparagraphs (G) [Mortgage Restructuring], (H) [Debt Forgiveness], or (I) [Budget-Based Rents]. The statutory requirement for taking one of the actions set out in Section 212(h)(1) is mandatory, not discretionary. Congress also provided the Secretary with the authority to take certain discretionary actions in order to facilitate the mandatory restructuring of the existing mortgage to an unpaid principal balance supportable at market rents. For example, Section 212(h)(1)(A)(i) provides the Secretary with the authority to remove any restrictions that would be an impediment to accomplishing the objective of restructuring the project mortgage loan down to an unpaid principal balance that is supportable at market rent. That clause states:

(i) IN GENERAL.--Consistent with the purposes of this section, subject to the agreement of the owner of the project and after consultation with the tenants of the project, the Secretary or designee may remove, relinquish, extinguish, modify, or agree to the removal of any mortgage, regulatory agreement, project-based assistance contract, use agreement, or restriction that had been imposed or required by the Secretary, including restrictions on distributions of income which the Secretary or designee determines would interfere with the ability of the project to operate without above-market rents.

Under the authority in Section 212(h)(1)(A)(i), the Secretary can

extinguish any restriction imposed on an owner/mortgagor by the Secretary that is not required by statute. We note that the multifamily mortgage insurance programs authorized by the NHA do not impose statutory prepayment restrictions. Prepayment restrictions contained in mortgage notes have been imposed administratively, most often by regulation. The authorizing legislation for the PRe Demonstration Programs, however, provides a statutory basis (i.e., through the provision quoted above) for the Secretary to extinguish a prepayment restriction and thereby remove any project mortgage restructured in the PRe Demonstration Programs from the universe of project mortgages that are subject to NHA Section 250.

In addition, Section 212(h)(1)(E) of the FY 1997 HUD Appropriations Act, through NHA Section 541, provides the Secretary with the authority, "notwithstanding any other provision of law," to "make a full payment of claim or partial payment of claim" in order to restructure the existing insured project mortgage down to an unpaid principal balance supportable at market rent. The Section 541 payment is the source of a mortgage prepayment which is made by HUD, on behalf of a mortgagor, to a mortgagee as part of a PRe Demonstration Program mortgage restructuring. Therefore, under Section 212(h)(1)(E), a Section 250 review by HUD is not relevant because HUD cannot deny a Section 541 prepayment which is made pursuant to the terms of a fully executed Mortgage Restructuring Commitment (i.e., signed by HUD and the project owner) under the PRe Demonstration Programs.

If an owner voluntarily enters into one of the PRe Demonstration Programs, the Secretary may restructure the mortgage loan and/or offer budget-based rents. The prepayment restrictions set out in HUD's regulations and inserted into the body of mortgage notes are a clear impediment to the Secretary's statutory obligation regarding a mortgage restructuring which is accomplished through a Section 541 claim that results in a full or partial prepayment of an existing first mortgage Note. Therefore, when the Secretary and an owner execute a Mortgage Restructuring Commitment containing terms for a reduction of a project's HAP contract rents down to market and for a restructuring of an existing FHA-insured project mortgage loan down to an amount that is supportable at those reduced market rents, we think the Secretary exercises the authority in Section 212(h)(1)(A)(i) and thereby extinguishes any mortgage prepayment restrictions previously imposed by the Secretary or the Commissioner, either by regulation or by the terms of the Note, or both. Consequently, the Secretary's execution of a Mortgage Restructuring Commitment, which also has been signed by a project owner, would extinguish any prepayment restriction and thereby would remove the insured project mortgage from the universe of project mortgage loans subject to NHA Section 250.

Section 219 of the FY 1999 HUD Appropriations Act requires an owner of preservation-eligible projects to give at least 150 days notice of mortgage prepayment to tenants, HUD, and the local

government. The notice requirement in Section 219 applies to preservation-eligible projects whose owners now may prepay their mortgage loans or terminate FHA mortgage insurance, "[n]otwithstanding section 211 of the Housing and Community Development Act of 1987 or section 221 of the Housing and Community Development Act of 1987 (as in effect pursuant to section 604(c) of the Cranston-Gonzalez National Affordable Housing Act)". As discussed above, Section 212(h)(1)(E) of the FY 1997 HUD Appropriations Act provides the Secretary with the authority, "notwithstanding any other provision of law," to "make a full payment of claim or partial payment of claim" in order to restructure the existing insured project mortgage within the PRE Demonstration Programs. (Emphasis added.) We believe that the "notwithstanding" provision in Section 212(h)(1)(E) supersedes the requirements of Section 219, thereby allowing the Department to make full or partial payments on behalf of the project owner for the existing mortgage loan without regard to the notice requirements in Section 219(b).

Please contact Edward Ferguson at 708-4107 if you have any questions about this memorandum.