

October 21, 2003

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CIM-0127

Subject: Section 541(b) Payments in Coinsured Mark-to-Market Restructurings

MORANDUM FOR: Charles H. Williams, Director, Office of Multifamily
Housing Assistance Restructuring, HY

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

SUBJECT: Section 541(b) Payments in Coinsured Mark-to-Market Restructurings

Your memorandum to me dated June 24, 2003 requests legal guidance regarding FHA's legal authority to make a Section 541(b) payment on behalf of the owner/mortgagor of a project mortgage securing a note endorsed for coinsurance under the National Housing Act. Specifically, the Massachusetts Housing Finance Agency, a co-insurance mortgagee, has a portfolio of approximately a dozen projects eligible for restructurings in the Mark-to-Market (M2M) Program which have coinsured mortgages. Some of these projects are reaching the point where OMHAR would be able to issue a Restructuring Commitment, but this would only be feasible if there is statutory authority for FHA to make a Section 541(b) payment to the coinsured mortgagee. Representative of this portfolio of coinsured projects is Granite Package #5 Blue Mountain, FHA Project #023-36609, which has a co-insured Section 221(d)(4) mortgage with an unpaid principal balance of approximately \$9,000,000.

When it created the Mark-to-Market program Congress provided the Secretary with certain mortgage restructuring tools, the most important of which is the authority set out in Section 541(b) of the National Housing Act for the Secretary to "make a one time, non-default partial or full payment of claim under one or more mortgage insurance contracts." One of the stated legislative purposes of the Mark-to-Market program as set out in Section 511(b) of MAHRA is "to reduce the cost of insurance claims under the National Housing Act related to mortgages insured by the Secretary and used to finance eligible multifamily housing projects."

Section 244 was added to the National Housing Act by Section 307 of the Housing and Community Development Act of 1974 and authorizes the Secretary to insure mortgages otherwise eligible for mortgage insurance, pursuant to a coinsurance contract with an approved mortgagee, if the mortgagee will assume a percentage of any loss; and will carry out credit approval, appraisal, commitment, inspection, management oversight, servicing, and property disposition. Section 244(a) provides in pertinent part that:

[T]he Secretary, upon request of any mortgagee . . . may insure and make a

commitment to *insure under any provision of this title* (emphasis added) any mortgage, advance, or loan otherwise eligible under such provision, pursuant to a co-insurance contract that the mortgagee will -- (1) assume a percentage of any loss on the insured mortgage, advance, or loan in direct proportion to the amount of the co-insurance.

Section 244 authorizes the Secretary to insure a mortgage under any section of the National Housing Act, it does not have its own insuring authority. Consequently, when the Secretary endorsed a mortgage for coinsurance, the mortgage was actually providing insurance under either Sections 221(d)(3)/(4) or Section 207 pursuant to Section 223(f). This is evidenced by the endorsement panel on the insured note which for projects in the Mark-to-Market program would have read as follows: "co-insured under Section 221(d)(3)/(4) pursuant to Section 244 of the Act," or co-insured under Section 207 pursuant to Section 223(f) and Section 244 of the Act." The endorsement panel language demonstrates that the insurance authority applicable to that mortgage note was pursuant to a coinsurance arrangement between the Secretary and an approved mortgagee that was entered into under the authority in Section 244 of the National Housing Act. The legislative history for Section 244 provides no evidence that Congress intended for the coinsurance of mortgages to be anything other than a mortgage insurance program under Title II of the National Housing Act.

In view of the foregoing, loans insured pursuant to Section 244 are loans insured under the National Housing Act. It is, therefore, our opinion that the Secretary is authorized to make a Section 541(b) non-default payment of claim to a coinsurance mortgagee on a mortgage insurance contract, under either Section 221(d)(3)/(4) pursuant to Section 244, or Section 207 pursuant to Section 223(f) pursuant to Section 244, on behalf of a mortgagor participating in the Mark-to-Market program. Further, we believe that 24 CFR 251.3 is not applicable to the Mark-to-Market program because the requirement in 251.3(b) that the "lender has made reasonable efforts to work out any Mortgage default" makes clear that the regulation, as drafted, was intended to apply to those situations when a mortgagor is in default under the terms of its co-insured note and mortgage, and that is not the case relative to a project undergoing a mortgage restructuring in the Mark-to-Market program.

If you have any questions concerning this legal opinion, please contact Edward Ferguson at 708-4107.

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