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To: Lenders  
cc:  
Subject: Pro rata disbursement of Tax Credits

We have received the below information from HQ's on what is proposed on the subject. Please let us know if you want to discuss how this affects a particular project that you are processing.

An Interim Rule was published in the Federal Register on July 30, 2003, entitled "Distribution of Tax Credit Proceeds" (FR-4792-I-01, effective August 29, 2003). This Interim Rule amends 24 CFR Section 200.54 to state that the mortgagor's equity from the sale of low-income housing tax credits (LIHTCs) or historic tax credits need not be fully disbursed before the distribution of mortgage proceeds.

24 CFR Section 200.54(a) requires that funds provided by the mortgagor be fully disbursed before disbursement of any mortgage proceeds. 24 CFR Section 200.54(b) provides for exceptions. Before August 29, 2003, the only exceptions are for grant/loan proceeds furnished by a government agency or instrumentality. Headquarters has issued numerous waivers of 24 CFR Section 200.54 during the last 2 years for projects that have LIHTCs or historic tax credits. These waivers have approved a pro-rata disbursement of the mortgagor's front money and the insured mortgage proceeds, frequently avoiding long delays in the disbursement of insured mortgage proceeds. This allows the borrower and lender to avoid the payment of GNMA extension fees. The amended regulation includes the mortgagor's front money from the sale of LIHTCs or historic tax credits in the exception category in 24 CFR Section 200.54(b), along with grant/loan proceeds furnished by a government agency or instrumentality.

As of August 29, 2003, local Hubs and Program Centers will have the authority to approve a pro-rata disbursement of the mortgagor's front money from the sale of LIHTCs or historic tax credits, and the insured mortgage proceeds, without requesting a waiver of 24 CFR Section 200.54 from Headquarters.

Handbook 4435.1, REV-1, "Project Construction and Servicing Before Final Closing," and the MAP Guide are being revised to reflect this change. Here are the terms, conditions, and standards for the pro-rata disbursement:

1. All of the mortgagor's front money, including tax credit proceeds, will have to be deposited with the mortgagee at initial endorsement under outstanding instructions and so reflected on the Mortgagee's Certificate.
2. The mortgagee and the HUD field office will negotiate the percentages of mortgagor's cash escrow and mortgage proceeds to be disbursed.
3. The pro-rata disbursement will have to be reflected on the Mortgagee's Certificate and the Building Loan Agreement. Form HUD-92403, "Application for Insured Advances of Mortgage Proceeds," will be processed in accordance with outstanding instructions, except that it must show the approved funding from both the mortgage proceeds and the mortgagor's cash escrow in proportion to the terms of the pro-rata agreement.
4. Release of the LIHTC or historic tax credit proceeds may not be targeted to the completion of specific on-site improvements.
5. Hubs/Program Centers can begin implementing these instructions on all tax credit cases to be initially endorsed on or after the effective date of 8/29/03.
6. Except for grants or loans from a government agency or instrumentality, letters of credit may not be substituted for front end cash. Proceeds from the sale of tax credits come from private sources, not from a government agency or instrumentality. See the below additional clarification on this.
7. These terms, conditions and standards are not waivable by HUB Directors. The appropriate Handbooks and MAP guide will be updated to reflect these instructions.

Additional Clarification sent from HQ's on #6 above:

It has come to our attention that Mortgagors/Sponsors are proposing to provide a Letter of Credit in lieu of providing cash at the closing to meet their cash "equity" requirements.

The regulation( 24 CFR 200.54) states; "The mortgagor shall deposit with the mortgagee cash deemed by the Commissioner to be sufficient, when added to the proceeds of the insured mortgage, to assure completion of the project and to pay the initial service charge, carrying charges, and legal and organization expenses incident to the construction of the project. The Commissioner may accept a lesser cash deposit or an alternative to a cash deposit in accordance with terms and conditions established by the Commissioner, where the required funding is to be provided by a grant or loan from a Federal, State, or local government agency or instrumentality.

(a) An agreement acceptable to the Commissioner shall require that funds provided by the mortgagor under requirements of this section must be disbursed in full for project work, material and incidental charges and expenses before disbursement of any mortgage proceeds, ....."

**The substitution of a Letter Of Credit for required cash equity is not permissible. Field Offices are not permitted to waive program regulations allowing sponsors/mortgagors to substitute a letter of credit for cash to meet the cash "equity" requirements of firm commitments.**

The **only exception** to this policy is where grant/ loan funds such as HOME and CDBG are provided from a government agency or instrumentality which executes an agreement with the Department. HUD Handbook 4470.1 Rev-2 16-4 and MAP Guide Chapter 8.11 D both state that for grants/loans from a government agency or instrumentality "the mortgagor may use instead of that portion of the front money escrow provided by the grant/loan, either: an unconditional irrevocable letter of credit issued by a banking institution, or an agreement entered into by HUD, the government agency or instrumentality, the Lender and mortgagor which provides the following: ....."

The above exception does not apply to tax credit transactions since proceeds from the sale of tax credits come from private sources.

The Interim Rule to 24 CFR 200.54(b), which becomes effective on August 29, 2003, provides that the proceeds from LIHTC need not be fully disbursed before the disbursement of mortgage proceeds. The purpose of this rule was to facilitate the use of GNMA MBS financing for tax credit transactions by allowing prorata disbursement of mortgage proceeds and borrower equity. The interim rule does not amend the long standing regulatory requirement that all of the borrower's equity be deposited in cash with the mortgagee at initial endorsement.

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