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DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

[Docket No. FR-5354-N-01]

RIN 2502-AI80

**HUD Multifamily Rental Project Closing Documents:
Proposed Revisions and Updates and Notice of Information Collection**

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Notice.

SUMMARY: This notice advises that HUD is issuing for public comment a comprehensive set of revised closing documents for use in Federal Housing Administration (FHA) multifamily rental projects. This notice starts anew the process for updating the multifamily rental project closing documents; that process commenced with an August 2, 2004, notice that presented proposed revised closing documents for public comment. The August 2004 notice was followed by an August 31, 2006, notice in which HUD provided updates on the closing document development process, advised of policy decisions that HUD had made at that time, and announced a September 21, 2006, public meeting at which HUD would take questions on the development process and policy decisions announced in the August 31, 2006, notice.

On June 1, 2009, HUD announced, on its website, that it would commence review of the multifamily rental project closing documents as last revised by the prior Administration and welcomed the public to review these documents along with HUD, as well as submit any informal comments on the revised closing documents.

In submitting the comprehensive set of revised multifamily rental closing documents for public comment, this notice also complies with the Paperwork Reduction Act of 1995. While

complying with the Paperwork Reduction Act of 1995, this notice provides information beyond that normally provided in such notices by identifying changes HUD has made to the proposed closing documents published on August 2, 2004, and summarizing and responding to issues raised by commenters on the 2004 proposed closing documents, and to those issues informally presented on the revised closing documents recently posted on HUD's website.

In revising these forms, HUD identified language and policies that were outdated and needed to be changed to be consistent with modern real estate and mortgage lending laws and practices. By reflecting current terminology and current lending laws and practices, updated multifamily rental project closing documents will better protect and benefit all parties involved in these transactions. The multifamily closing documents are posted on HUD's website at www.hud.gov/offices/hsg/mfh/mfhclosingdocuments.cfm.

DATES: Comment Due Date: **March 22, 2010**

ADDRESSES: Interested persons are invited to submit comments regarding this notice to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

Communications must refer to the above docket number and title. There are two methods for submitting public comments. All submissions must refer to the above docket number and title.

1. Submission of Comments by Mail. Comments may be submitted by mail to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, DC 20410-0500.

2. Electronic Submission of Comments. Interested persons may submit comments electronically through the Federal eRulemaking Portal at www.regulations.gov. HUD strongly encourages commenters to submit comments electronically. Electronic submission of comments

allows the commenter maximum time to prepare and submit a comment, ensures timely receipt by HUD, and enables HUD to make them immediately available to the public. Comments submitted electronically through the www.regulations.gov website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Note: To receive consideration as public comments, comments must be submitted through one of the two methods specified above. Again, all submissions must refer to the docket number and title of the rule.

Redline/Strikeout Submissions. While commenters may submit, as part of their comments, a redline/strikeout of any one or more of the multifamily rental project closing documents, the redline/strikeout drafts, to be considered, must be accompanied by a narrative statement that explains the proposed changes.

No Facsimile Comments. Facsimile (FAX) comments are not acceptable.

Public Inspection of Public Comments. All properly submitted comments and communications submitted to HUD will be available for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, an advance appointment to review the public comments must be scheduled by calling the Regulations Division at 202-708-3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Information Relay Service at 800-877-8339. Copies of all comments submitted are available for inspection and downloading at www.regulations.gov.

FOR FURTHER INFORMATION CONTACT: John J. Daly, Office of the General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 9226, Washington,

DC 20410-0500; telephone number 202-708-1274 (this is not a toll-free number). Persons with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Background

II. This Notice

III. Overview of Proposed Policy Determinations and Changes Made to Closing Documents

A. Documents to Which No Changes Were Made

B. Across-the-Board Changes and Policy Determinations

C. Changes Made to Specific Documents and Addition of New Document

IV. Discussion of Public Comments

V. Findings and Certifications

VI. Solicitation of Public Comments

I. Background

On August 2, 2004, HUD published a notice in the Federal Register (69 FR 46214) that advised that, consistent with the Paperwork Reduction Act of 1995, it was publishing for public comment a comprehensive set of revised closing forms and documents (closing documents) for use in the FHA multifamily rental project and health care facility (excluding hospitals) programs. In addition to meeting the requirements of the Paperwork Reduction Act, HUD advised that it was not solely seeking public comment on burden hours, as is the primary focus of the Paperwork Reduction Act, but seeking public comment for the purpose of receiving input from the lending industry and other interested parties in HUD's development and adoption of a set of

instruments that offer the requisite protection to all parties in these FHA-insured mortgage programs, while also being consistent with modern real estate practice and mortgage lending laws and procedures. The August 2, 2004, notice advised that HUD's closing documents were significantly outdated and needed a thorough review and update to reflect current HUD policies, as well as current practices in real estate and mortgage financing transactions.

The August 2, 2004, notice followed an earlier informal solicitation of public comment on proposed revisions to the closing documents, that were posted on HUD's website in March 2000. In response to the many comments received from the 2000 solicitation of public comment, significant revisions were made to the proposed closing documents, and these revised documents were published in the Federal Register on August 2, 2004, for review and public comment.

On August 31, 2006, HUD published a notice in the Federal Register (71 FR 51842) that announced certain policy decisions that had been made with respect to HUD's development of closing documents as of August 2006. HUD issued that notice in response to inquiries about the status of HUD's development of the closing documents. In that notice, HUD also announced that it would hold a meeting on the status of development of the closing documents at HUD Headquarters on September 21, 2006. HUD invited to this meeting the 25 individuals and organizations that submitted comments on the August 2, 2004, notice, welcomed other interested parties to the meeting, and made phone lines available to those unable to participate in person. The purpose of the meeting was to brief the commenters and other interested members of the public on the status of the development of revised closing documents as of August-September 2006.

In the August 31, 2006, notice and at the meeting, HUD announced that the following decisions had been made as of that date.

1. Health Care Facility (e.g., nursing homes) documents would be published again for public comment (e.g., on issues such as treatment of accounts receivable financing) as proposed documents;
2. Revised documents other than documents pertaining exclusively to health care facilities (e.g., rental projects) would be published as final documents without further comment;
3. All revised documents would be updated periodically (e.g., every 3 years to coincide with renewal of Office of Management and Budget (OMB) numbers under the Paperwork Reductions Act);
4. Updates to revised documents that are needed more frequently than periodic updates will be made on a case-by-case basis;
5. Recourse liability for Key Principals would not be a HUD requirement, as proposed in the documents in the August 2, 2004, Federal Register notice;
6. A clear definition of “HUD Directives” would be provided; and
7. The effective date for the revised documents would provide time for the processing of pending FHA mortgage insurance applications, as well as for training on the revised documents.

HUD was unable to complete the updating of the closing documents during the prior Administration. On June 1, 2009, HUD announced, on its website, that it would commence review of the multifamily rental project closing documents, as last revised by the prior Administration, and welcomed the public to review these documents along with HUD, as well as submit any informal comments on the revised closing documents. (See <http://www.hud.gov/offices/hsg/mfh/mfhclosingdocuments.cfm>.) The revised closing

documents reflected most of the decisions previously made in response to public comments received on the August 2, 2004, proposed closing documents, but not necessarily all of the decisions announced in the August 2006 notice. The June 2009 Internet posting advised that the new HUD Administration had begun its review of the closing documents to consider changes that may be appropriate given policy decisions by a new Administration and in recognition of changes in the multifamily rental housing industry that had occurred since the documents were first proposed for public comment. HUD invited its industry partners, the legal community, and other interested members of the public to review the documents along with HUD and to submit informal comments to a specified email address.

II. This Notice

This notice identifies changes HUD has made to the proposed closing documents since it last published them on August 2, 2004. This notice also advises the public of changes proposed by the new HUD Administration, which reviewed those documents in the context of changed industry conditions since 2004 and 2006, and took into consideration changes previously decided to be made, and the feedback received through the June 2009 informal process. This notice summarizes and responds to issues raised in the 2004 public comments and, consistent with the Paperwork Reduction Act and HUD's own interest in receiving further formal comment on the proposed closing documents, solicits public comment on the revised closing documents. All of the closing documents, which include the most recent proposed changes, are posted on HUD's website at <http://www.hud.gov/offices/hsg/mfh/mfhclosingdocuments.cfm>.

III. Overview of Proposed Policy Determinations and Changes Made to Closing Documents

In addition to identifying changes made to the closing documents to update terminology and improve clarity and comprehension, this section of the preamble highlights some of the more

significant changes that were made to those closing documents published for public comment in August 2004.

A. Documents to Which No Changes Were Made

As will also be highlighted below, in the overview of key changes to the closing documents, no substantive changes to the documents published on August 2, 2004, were made to the following documents:

Agreement of Sponsor to Furnish Additional Funds;

Bond Guaranteeing Sponsors' Performance;

Completion Assurance Agreement;

Escrow Agreement for Incomplete Construction;

Escrow Agreement for Latent Defects;

Off-Site Bond – Dual Obligee;

Payment Bond;

Performance Bond;

Request for Approval of Advance of Escrow Funds;

Request for Final Endorsement of Credit Instrument;

Residual Receipts Note Limited Dividend;

Residual Receipts Note Nonprofit;

Surveyors Report.

In addition, no comments were received and no changes were made to the Supplement to Building Loan Agreement.

B. Across-the-Board Changes and Policy Determinations

Section 232 (Health Care Facility) Documents.

As a result of the comments received on the 2004 proposed Section 232 closing documents, HUD has determined to revise these documents and publish them at a future date for additional public comment.

Recourse Liability.

The introduction of certain limited recourse liability for Key Principals in the 2004 proposed closing documents was opposed by several public commenters, and HUD's August 31, 2006, notice stated that HUD had decided not to include provisions for recourse liability of Key Principals. The revised closing documents posted on HUD's website on June 1, 2009, however, retained some of those provisions. Some of the informal comments again opposed inclusion of any recourse liability provisions, arguing that inclusion would dissuade individuals from participating in HUD- insured multifamily housing transactions.

In light of the consequences that certain insufficiently regulated actions have had on the housing finance markets in recent years, and given that public funds are put at risk in HUD multifamily housing transactions, it is now HUD's position that it is appropriate for principals to have recourse liability for certain "bad boy acts." Accordingly, these provisions continue to be included in the revised closing documents being issued for comment under this notice.

Directives.

One of the more significant changes made in revising the 2004 closing documents is to clarify the reference to the term "Directives" in the closing documents. Concern about the inclusion of this term and its meaning was an issue raised in many of the comments. At HUD's September 21, 2006, meeting to report on the status of the development of the closing documents, HUD advised that it would provide a clear definition of this term. While a clear definition has been provided in the revised closing documents being issued for comment under

this notice, on further consideration, HUD has determined to use the term “Program Obligations” rather than “Directives.” HUD’s view is that the term “Program Obligations” better captures what was intended by use of the term “Directives,” namely, to advise parties to the closing documents of the additional requirements, beyond those included in the documents themselves, to which they are expected to adhere. The language would define “Program Obligations,” as follows:

Program Obligations means all applicable statutes and regulations, including all amendments to such statutes and regulations, as they become effective; and all applicable requirements in HUD handbooks, notices, and mortgagee letters that apply to the Project, including all updates and changes to such handbooks, notices, and mortgagee letters that apply to the Project, except that updates and changes subject to notice and comment rulemaking shall become effective upon completion of the rulemaking process. Handbooks, notices, and mortgagee letters are available on HUD's official website (www.hudclips.org or a successor location to that site).

The advantage of this language is that it identifies the specific, longstanding, and familiar types of requirements (those in statutes, regulations, handbooks, notices, and mortgagee letters) to which the parties must adhere. To provide an additional level of assurance to commenters who expressed concern over the possibility that they would be required to comply with any future provision that HUD might issue in any manner, the definition also explicitly states that notice and comment rulemaking will be followed for any requirements that would be subject to such procedures. These procedures address concerns raised about adherence to future directives by the commenters, including concerns about conflicts with existing requirements, retroactive application of new requirements, or lack of time to prepare for transition to new requirements.

For example, the imposition of new or revised information collection requirements (that is, generally new or revised forms) must undergo the notice and comment processes required by the Paperwork Reduction Act of 1995. From time to time, mortgagee letters or other types of

direct notices will be used to announce new binding requirements. These documents are appropriate for announcements when new legislation imposes requirements that are effective upon enactment and leave HUD no discretion in implementation, and it is important for HUD to relay this information to the industry as quickly as possible. In such situations, mortgagee letters or other types of direct notices are the best vehicles to relay this information to the industry and to advise of implementation dates and provide implementation guidance, including transition periods where applicable and permitted by statute that may be helpful to the industry. From time to time, HUD may also issue mortgagee letters or direct notices to announce clarifications, interpretations, or certain procedural requirements, such as to which HUD offices or HUD officials certain types of executed documents must be submitted. In brief, HUD will follow the applicable procedures, as directed by statute or regulation, that govern issuance of a document which may announce additional policies, processes, forms, or standards to which parties to the closing documents must comply.

C. Changes Made to Specific Documents and Addition of New Document

This section C of the preamble describes changes made to the proposed closing documents since they were published for comment on August 2, 2004, including changes in response to formal comments on the August 2, 2004, proposed closing documents, changes in response to informal public comments on the revised closing documents posted on June 1, 2009, and changes proposed by the new HUD Administration, which reviewed the documents in the context of changed industry conditions. Citations to specific sections or paragraphs of the closing documents refer to the versions of documents currently posted on HUD's website and may differ from the section or paragraph designation in which the relevant provision appeared in prior versions of the documents.

In addition, this section C of the preamble addresses a new Subordination Agreement that HUD is proposing to require on affordable housing transactions with government subordinate debt. The Subordination Agreement would replace the rider to the subordinate note that HUD presently uses.

Agreement and Certification Changes

1. In section 4, inserted “managers, managing members, members” to the Borrower entity which may have an identity of interest with the Architect or General Contractor that must be disclosed to HUD.

2. Removed section 14 that required the General Contractor and Borrower to certify that there were no undisclosed side agreements.

Borrower’s Oath Changes

1. Added a new section 4 to require the Borrower to certify that it has not and will not enter into any agreement with any party other than the Lender that allows perfection of any security interest in the Uniform Commercial Code (UCC) Collateral through control under the UCC. This change is in accordance with revisions to Article 9 of the UCC.

2. In response to informal public comment, added a new provision regarding knowledge of proposed laws and ordinances that would affect the project. This provision has been removed from Opinion of Counsel to Borrower and added to the Borrower’s Oath, because the Borrower is in a better position to have the relevant knowledge.

Building Loan Agreement Changes

1. Clarified paragraph 4(c) by inserting language related to “over and above” funds.

2. Removed paragraph 19 because it contained references to personal liability of Borrower.

3. Revised paragraph 5 to change the reference to a new Exhibit B, which will list applicable charges or items to which advanced funds are to be applied.

4. Revised paragraph 9 to provide that the covered acts constitute abandonment, and to define more precisely what acts constitute abandonment.

Construction Contract Changes

1. Inserted a subsection (11) to Article 2 that adds any HUD-approved change orders.

2. Inserted the following parenthetical, instructional language into Article 4(d):

“(Insert that portion of the sum of interest, taxes, insurance, and Mortgage Insurance Premium that appears in section G of HUD-92264 attributable to the construction period. If there has been a change in the interest rate charged for the construction period (see footnote designated (***) on page 1 of HUD-92443), the dollar amount included in section G of HUD-92264 must be adjusted. The adjusted amount must be reflected in the savings computation.) Furthermore, the procedures set forth in footnote designated (***) on page 1 of HUD-92443 must be followed.”

3. Added language to Article 6(d) that this section is applicable only if “permitted under state law.”

4. Added language to Article 7(c) that the land survey map must be prepared in accordance with American Land Title Association/American Congress on Surveying and Mapping (ALTA/ACSM) standards and the HUD Surveyor’s Report. Language is also added in the same section that if the Contractor has deviated from the Plans and Specifications, the Contractor will be responsible, at its own expense, for correcting any such deviations.

5. In Article 2(9), revised the designation for the wage determination number and date to

include the modification number and date.

6. In Article 2, added a new paragraph 12 to add “any side agreements disclosed to HUD” to the list of Contract Documents.

Escrow Agreement for Operating Deficit Changes

1. Changed the term “sponsor” to “maker.”
2. In accordance with a request in an informal public comment, revised section 4 to provide a definition of Sustaining Occupancy, which provides that Sustaining Occupancy must have been maintained for 10 of the prior 12 months.
3. In response to an informal public comment, revised section 5 to permit the Lender to draw upon a letter of credit in escrow and convert it to cash, provided that interest accrues to the relevant account.

Escrow Agreement for Noncritical Deferred Repairs Changes

1. Inserted a new section 4 to clarify how disbursements from the escrow are to be authorized by HUD.
2. Inserted a new section 11 that Lender will hold and disburse the escrow at HUD’s direction.

Escrow Agreement for Working Capital Changes

1. In section 1, added “and/or” after the checkbox for “cash” to show HUD’s new policy of allowing a mixture of cash and a letter of credit.
2. In section 3, removed the language that interest earned on the escrow deposit would be returned to Borrower.
3. Modified section 3 to indicate that the remaining balance of the escrow funds would be returned to Borrower after the date of sustaining occupancy.

4. Removed section 4, in accordance with section 2834 of the Housing and Economic Recovery Act of 2008 (Public Law 110-289, approved July 30, 2008), which prohibits HUD from requiring the deposit into escrow of equity from Low Income Housing Tax Credits. The remaining sections have been renumbered accordingly.

5. In section 6, removed the language “together with interest” to be consistent with the changes in section 3.

Guide for Opinion of Borrower’s Counsel Changes

In connection with HUD’s effort to revise the closing documents, HUD also analyzed considerable public comment upon the Guide, as well as ongoing comments by users and the public in the years that the Guide has been in use. The public comment has been invaluable in an effort to bring the Guide into compliance with more modern opinion practice, while simultaneously recognizing the singular and unique role of an attorney representing a Borrower in a HUD mortgage insurance transaction in the areas indicated above.

1. In the introductory section, removed the sentence that describes how the loan is to be funded.

2. In section G, added language that HUD should be listed as secured party, as its interest appears.

3. In section LL, added language to include financing from “other third party sources.”

4. Removed section “NN,” which required review by counsel of the architect’s certificate.

5. In new section “NN” (old section “OO”), added “managing member, or similar person or entity of Borrower” to subsection (iii).

6. In section 2, removed language that has counsel opining as to whether Borrower

possesses all necessary governmental certificates, permits, licenses, qualifications, and approvals to own and operate the Property.

7. Removed section 4.

8. Removed section 9.

9. In section 13 (now new section 11), added “as its interest appears” with respect to HUD and Lender.

10. Removed section 14 and moved it to the Lender’s Certificate (formerly the Mortgagee’s Certificate), because it is more appropriate to have the Lender certify that the Loan does not violate usury laws than to have counsel to Borrower certify this item.

11. In the last portion of the Guide, where counsel certifies certain items, removed sections (e) and (g) and added in (d) a reference to interests disclosed and “approved.”

12. In response to informal public comments, removed opinions that are more appropriately rendered by other parties. For example, the Lender, rather than Mortgagor’s counsel, is responsible for UCC filings, so the relevant provisions have been added to the Lender’s Certificate. Additionally, section 6, regarding proposed laws and ordinances that would affect the project, has been removed and added to the Borrower’s Oath.

13. Moved the substance of section 9, regarding pending litigation and claims, to confirmations section (h), since it pertains to a factual matter rather than a legal opinion.

14. Provided for signature of the opinion by an authorized partner of the law firm.

Instructions to Guide for Opinion of Borrower’s Counsel

Revised the instructions in accordance with changes to the Guide for Opinion of Borrower’s Counsel, which are described above.

Exhibit A – Certification of Borrower

1. Changed section 3 to be in conformity with revised Article 9 of the Uniform Commercial Code (UCC).
2. Added a new section 4 identifying the state where Borrower was formed.
3. Moved section originally designated as 7 (before addition of new section 4, noted immediately above), which contained certification for sources of funds, to section 20(e) of the Lender's Certificate.

HUD Amendment to AIA Document B181 Between Owner and Architect Changes

In former section 10, now section 11, inserted “partners, managers or member” to explain where an identity of interest could exist.

Lease Addendum Changes

Clarified the document to show that this Lease Addendum is to be used for a transaction where the mortgage is secured by a ground lease and is not to be used for the lease of commercial space.

Mortgagee's Certificate Changes

1. Changed the title of the document from “Mortgagee's Certificate” to “Lender's Certificate,” to be consistent with the change in all documents that provides for using the term “Lender” instead of “Mortgagee.”
2. Added language to section 1 and a new section 3 that make all successors and assigns of the Lender bound by the Lender's Certificate. Succeeding sections have been renumbered accordingly.
3. Removed first checkbox item in section 11, which has been redesignated as section 12.

4. Added language in section 13 that Borrower represents and warrants to Lender that no UCC filings have been made against Borrower prior to the initial or initial/final endorsement of the Note by HUD.

5. Changed language in section 14 to allow other investments approved in writing by HUD.

6. Revised section 16 to indicate that Lender agrees to obtain HUD's approval and consent when needed, as set forth in the Security Instrument, and to furnish HUD with all reports and data as set forth in the Security Instrument.

7. Revised section 20(f) to require the lender to disclose the amount of any trade profit that is to be collected in a transaction. Trade profit, also known as a "premium" or "marketing gain," is the amount of additional funds, over and above the mortgage amount, paid by the purchaser of the mortgage backed securities that are used to fund the HUD-insured loan. The funds are paid in recognition of the difference between the mortgage interest rate used in the HUD-insured loan and what would generally be available at par in the market at any given time.

8. Added, as section 30, a new certification of Lender that Borrower possesses all necessary governmental certificates, permits, licenses, qualifications, and approval to own and operate the Property. This provision was formerly a part of the Opinion of Counsel to the Borrower.

9. Added, as section 31, a new certification of Lender that Borrower has furnished Lender with copies of all authorizations, consents, approvals, and permits from all necessary jurisdictions and courts.

10. Added, as section 32, a new certification of Lender that Lender has reviewed the title policy for any liens not reflected as exceptions to coverage in the title policy.

11. Added, as section 33, Lender's agreement that violations under the Regulatory Agreement will be treated as a default under the Security Instrument only when HUD requires Lender to do so and that Lender may accelerate the debt only upon the direction of HUD when there is a default under the Regulatory Agreement.

12. Added a section that Lender agrees to require Borrower to keep the Mortgaged Property insured at all times.

13. Added a section that Lender certifies that the insured loan does not violate usury laws.

14. Added a section that Lender certifies that, if there is a sale or transfer of all or a partial interest in the Note or a change in the Service Provider, Lender shall ensure that Borrower is given notice of this change.

Multifamily Regulatory Agreement Changes

1. Changed definitions of Fixtures, Mortgaged Property, Personalty, and Principals to be consistent with the Security Instrument definition.

2. Changed definition of Elderly person to be consistent with the definition in the current Regulatory Agreement.

3. Changed the definition of Mortgaged Property to add items (6) insurance policies and (16) deposits and escrows under collateral agreements.

4. Subject to the additional change described below in item number 21, changed the definition of Reasonable Operating Expense to include routine repairs.

5. Changed definition for Rents.

6. Added definition for Waste consistent with the Security Instrument.

7. Added provision to section 13, "Property and Operation; Encumbrances" that

Borrower must notify HUD of any bankruptcy filing or insolvency or reorganization or the retention of any attorneys, consultants, or other professionals in anticipation of such a filing (versus an absolute prohibition – HUD is merely giving them notification requirements), that Borrower must notify HUD of all payments received from an insurer and that tax penalties shall not be charged to the Project.

8. Removed section 17.

9. Added provision to section 23 (now designated section 22), “Management Agreement,” that a management agreement cannot be assigned without prior written HUD approval.

10. Changed section 26 (now designated section 25) to require that contracts for goods, materials, supplies, and services be obtained at costs, amounts, and terms that do not exceed reasonable and necessary levels and those customarily paid in the vicinity, and that the purchase price is based on quality, durability, and scope of work and shall be most advantageous terms to Project operation.

11. Removed the third-party beneficiary provision from section 28 (now designated section 27).

12. Revised and combined sections 34, 35, 36, and 37 into one section.

13. In section 37(k) (previously designated section 42(k)), changed the litigation costs from \$25,000 to \$100,000 and qualified its application to situations not funded by proceeds from professional liability insurance.

14. Section 44 has been redesignated section 39, and previous section 44(g), allowing HUD under certain circumstances to direct Borrower to replace certain parties, has been removed.

15. Changed section 46, now designated section 41, to revise references to personal liability of any entity or person and to provide for personal liability of listed Key Principals under the stated circumstances.

16. In section 47, now designated section 43, removed language at end of section regarding tenant protection rights.

17. Revised section I.1.a to define “Affiliate,” by cross-referencing to the definition of “Affiliate” in 24 CFR 200.215(a).

18. In section I.1.s, revised the definition for Non-Profit Borrower, to provide that the term means an entity that is treated under the firm commitment as an entity organized for purposes other than for profit or gain, pursuant to section 501(c)(3) or other applicable provisions of the Internal Revenue Code of 1986. This change responds to an informal public comment and recognizes that in most cases a borrower that meets the requirements of the Internal Revenue Service (IRS) for not-for-profit entities will also meet HUD’s requirements, but that there are some circumstances in which a not-for-profit entity will not be treated as a Non-Profit Borrower.

19. In section I.1.w, revised the definition of “Principal,” to cross reference to the definition of “Principal” in 24 CFR 200.215(e). This change is consistent with that made to the Security Agreement, discussed above.

20. In section I.1.x, revised the definition for “Project Assets”. This change responds to informal public comments and provides a clearer distinction between funds that are subject to HUD requirements and funds that are not.

21. In section I.1.bb, revised the definition for “Reasonable Operating Expenses” to cross-reference Program Obligations.

22. Revised section 11.c to clarify that the Borrower must provide for investment of Reserve for Replacement funds in accordance with Program Obligations. This change responds to an informal public comment stating that the Borrower does not have direct control over funds that remain in the possession of the Lender.

23. In response to an informal public comment, revised section 11(e) to clarify that the reference is to “this Agreement” and to remove the word “charter.”

24. Added a section 11.f to clarify that upon satisfaction of all HUD obligations, the Borrower shall receive any remaining Reserve for Replacement funds, so long as HUD has determined that all other obligations have been paid. This change responds to an informal public comment requesting that the disposition of such funds be clarified.

25. Revised section 15 to provide that upon completion of all repairs, HUD may permit escrowing of Distributions, pending inspection of the Project.

26. Revised section 22 to remove the requirement for management agreements to be approved in writing by HUD, but provides that they must be consistent with Program Obligations.

27. Revised section 32(a) to permit the Borrower to exclude children in certain projects, in accordance with Fair Housing Act requirements and as approved in writing by HUD. This change responds to an informal public comment stating that the previous language seemed to prohibit housing designated exclusively for elderly persons.

28. Revised section 37(j) to provide a non-exhaustive list of amendments to the organizational documents that require prior HUD approval, and to require copies of all amendments to the organizational amendments that must be submitted to HUD within specified time frames. This change responds to an informal public comment suggesting that some changes

to organizational documents are immaterial to HUD and should not require prior HUD approval.

29. Revised and consolidated the signature block and certification so that the Borrower's principals are required to sign the Regulatory Agreement only once. Although HUD disagrees with an informal public comment that the certification serves to expand upon standard recourse carve-outs, HUD agrees that the signature block should be consolidated so that multiple signatures are not required.

Note

1. The reference to Healthcare Facility has been dropped from the title of the document.
2. Added new section 8(d) regarding Borrower's obligation to indemnify under section 51, now designated section 49, of the Security Instrument.
3. An alternative section 9(a)(1) has been added to provide that the prepayment lockout language will be included in a rider to the Note that will provide appropriate language for the particular transaction involved because it is not possible to include all forms of lockout provisions in the Note.
4. Revised section 7, Late Charge, to provide that the late charge applies when the lender does not receive payment within 10 days after the payment is due. The change responds to an informal public comment that suggested that standardizing the time when the late fee applies would facilitate compliance by Ginnie Mae issuers with their obligation to make payments to investors.

Request for Endorsement of Credit Instrument Changes

I. Certificate of Lender

1. Redesignated section 14, in which Lender certifies that the insured loan does not violate usury laws, as section D.13.

2. Removed section 28 related to off-site components and the filing of UCC financing statements.

3. Redesignated section 32 as new section A.14.

4. Redesignated section 33 as new section A.13.

5. Redesignated section 34 as new section A.9.

6. Redesignated section 35, which states that if the Security Instrument is assigned to HUD, HUD is not bound by the requirements of this document, as section A.12.

7. Revised section 13 to reflect additional lender responsibilities and required representations related to UCC security interests, including performance of UCC searches and the perfection and maintenance of UCC security interests. The provisions have been removed from the Guide for Opinion of Borrower's Counsel to reflect that the Lender, rather than Mortgagor's counsel, is responsible for these UCC matters.

8. Revised section 15 to remove the requirement for the Lender to notify HUD when it knows that the Borrower is not in compliance with Program Obligations with respect to Residual Receipts. The change responds to an informal public comment stating that the Lender is not likely to know whether or not the Borrower has deposited the correct amounts with the Lender.

9. Revised section 38 to clarify the definition of Finance Charges.

10. Added section 40, in which the Lender certifies that a perfected first lien security interest has been established in favor of the Lender and HUD.

II. Certificate of Borrower

1. Removed sections 1, 3, and 5.

2. Added a new section B.4 regarding UCC filings.

Security Agreement Changes

1. Changed title from “Multifamily/Health Care (Mortgage, Deed of Trust, or Other Designation as Appropriate in Jurisdiction) Assignment of Rents and Security Agreement” to “Multifamily (Mortgage, Deed of Trust, or Other Designation as Appropriate in Jurisdiction) Assignment of Leases and Rents and Security Agreement.”

2. Replaced the term “Directives” with “Program Obligations” and provided a definition for “Program Obligations.” (Please see discussion of “Directives” and “Principal Obligations” earlier in this preamble.)

3. Changed the definition of “Mortgaged Property”, now designated section 1(y), to add insurance policies to section 1(y)(6).

4. Added as section 1(y)(16) in the definition of “Mortgaged Property,” that all deposits and/or escrows held by or on behalf of the Lender under collateral agreements are part of the Mortgaged Property.

5. Changed the definitions of “Fixtures” and “Personalty” to be consistent with the revised Article 9 of the UCC.

6. Changed definition of “Waste.”

7. Changed section 6, “Exculpation,” to indicate that no personal liability is being imposed on Borrower except such judgment or decree as may be necessary to foreclose or bar Borrower’s interest in the Mortgaged Property and all other property mortgaged, pledged, conveyed, or assigned to secure payment of the Indebtedness.

8. Removed section 9 dealing with collateral agreements, moved text to section 7(c), and renumbered remaining sections.

9. Added “upon reasonable notice” to the notice provision in section 14, which

previously was designated as section 15.

10. Revised the introductory language of section 15(b) (section 15 was previously designated as section 16) to clarify that Borrower provides the listed information for review by Lender, added new section 15(e) and redesignated section (e) as section (f), and redesignated remaining section accordingly.

11. Removed section 20 (Management Contracts) and renumbered remaining sections.

12. Added to section 23 (renumbered as section 21) new sections (d) and (e) to address ownership changes due to corporate restructuring and first-user syndications, respectively.

13. Removed section 22(b)(5) (section 22 was previously designated section 24), which included bankruptcy as a Class B Event of Default.

14. Removed from section 40, previously designated as section 42, the waiver of Borrower rights concerning disclosures of information.

15. Removed section 51(b)(i) and (ii) (section 51 is now redesignated as section 48) and renumbered remaining sections. Additional changes to the environmental requirements in section 51, now redesignated section 48, are discussed in the responses to the public comments on these requirements that appear below in this preamble.

16. In section 1, revised the definition of Principal to cross-reference to the definition of this word in 24 CFR 200.215(e). This change responds to an informal public comment that expressed concern about uncertainty that might arise from inconsistent definitions.

17. In section 2, updated provisions governing the perfection of security interests, in accordance revised Article 9 of the UCC.

18. Removed section 4(f)(3), which set forth provisions that must be included in telecommunications leases. This change responds to an informal public comment stating that

the conditions were too prescriptive, and allows approval of any proposed nonresidential lease to be considered by HUD on a case-by-case basis.

19. Revised section 21 to permit the Lender to charge the Borrower a fee, in accordance with Program Obligations, for the Lender's increased responsibilities in reviewing a proposed transfer of physical assets. This change responds to informal public comments expressing concern that a Lender should not be expected to perform additional responsibilities without reasonable compensation.

20. In response to informal public comment, clarified section 22(a), by replacing the potentially confusing term "grace period" with the term "period."

Surplus Cash Note

1. In response to an informal public comment, revised the introductory paragraph to provide for the possibility of semi-annual payment.

2. In response to an informal public comment, revised paragraph 7 to clarify that the Surplus Cash Note shall not be prepaid, except from non-Project sources and with written approval from HUD.

HUD Survey Instructions and Report Changes

Changed reference to the land Title Surveys standards of the ALTA and ACSM from the 1999 version to the 2005 version.

Supplementary Conditions of the Contract for Construction

Changed article 1.B.3(ii) regarding the required submission of payroll records without individuals' Social Security numbers and addresses. The change conforms to revisions to Department of Labor regulations at 29 CFR 5.5.

Additional Proposed Closing Document: Subordination Agreement

HUD is also proposing to require a new Subordination Agreement on affordable housing transactions with government subordinate debt. The Subordination Agreement would replace the rider to the subordinate note that HUD presently uses. Use of a HUD-proscribed form of Subordination Agreement is consistent with the established practice in the wider lending industry and better protects HUD's security in the real estate. The Subordination Agreement contains specific conditions on allowing the subordinate debt in order to protect HUD's first lien security. The Subordination Agreement is more expansive than the Rider, and it addresses a variety of legal issues that arise in the relationship between senior and subordinate lenders. Finally, the Subordination Agreement is a recorded instrument that appears in the chain of title and is easily located and amended to accommodate unique loan issues that may be important to the subordinate lender and acceptable to HUD.

IV. Discussion of Public Comments

The public comment period on the August 2, 2004, notice closed on October 1, 2004. HUD received 25 comments on the notice. Comments were received from law firms, mortgage companies, and industry organizations. In addition, five comments were submitted after the close of the comment period. Although submitted after the comment period, HUD reviewed these comments to determine whether issues were raised that had not been raised by the timely submitted comments.

The following discussion presents the significant issues, questions, and suggestions submitted by the public commenters and HUD's response to these issues, questions, and suggestions. The discussion first addresses general comments, then comments that address particular documents. The section or paragraph of a document addressed by the comment is also identified. For consistency, the term "section" rather than "paragraph" is used throughout the

discussion. This discussion addresses comments received in response to the closing documents when they were published for public comment on August 2, 2004, but does not provide individual responses to informal public comments on the revised closing documents posted on June 1, 2009. Citations to specific sections of the closing documents in the summaries of public comments, below, refer to the versions of closing documents originally published for public comment on August 2, 2004. HUD's responses to the public comments below reflect the versions of closing documents currently posted on HUD's website. Section designations and substantive provisions may differ from versions of the closing documents previously published in the Federal Register; discussed in the August 31, 2006, Federal Register notice or at the September 21, 2006, public meeting; or posted on HUD's website on June 1, 2009.

As noted above in the discussion of HUD's August 31, 2006, notice and September 21, 2006, meeting, the Section 232 Health Care Facility documents will be published again for public comment. The comments received on the Health Care Facility documents will be discussed when these documents are published again for public comment.

General Comments

Comment period

Comment: While some commenters commended HUD for providing a notice and comment opportunity on the revised documents, other commenters wrote that the 60-day comment period was not a fair and reasonable response time frame considering the magnitude of the changes proposed. Commenters asserted that there had been virtually no private sector discussion on matters that FHA must have known would raise serious industry concerns and expressed concern that while many of the changes may be appropriate, without careful coordination, there will be unplanned consequences and conflicts with existing HUD documents,

many of which may be to HUD's detriment. Several commenters requested additional time for consideration of the documents and the submission of comments.

HUD response: Since HUD is issuing revised closing documents once again for public comment and allowed for informal comment in 2009, the concern raised by the commenters is no longer relevant. Clearly, to date, HUD has provided more than 60 days to review revised closing documents. Nevertheless, HUD found this concern not to be accurate as applied to HUD's 2004 notice soliciting comment on revised closing documents. When HUD published revised closing documents for comment in 2004, HUD's plans to revise these documents were already well known in the private sector for a considerable period of time before the publication of the 2004 revised documents. This was recognized by several commenters who noted, in their comments on the 2004 documents, the long gestation period for revised closing documents to be issued. As the preamble to the proposed revised documents published in 2004 noted, HUD determined how the forms could be revised with input from HUD attorneys, FHA multifamily lenders, and counsel to parties to HUD-insured transactions. Drafts of proposed revised closing documents were first posted on a HUD website at the end of March 2000, and comments were solicited from the public and industry representatives. In response to the many comments received at that time, significant changes were made to several of the draft documents, and those changes were incorporated in the proposed closing documents published for comment on August 2, 2004.

With issuance once again of revised closing documents with a 60-day period to public comment, and given the opportunity in June 2009 to further comment on revised closing documents, HUD believes that the adequacy of opportunity to review and comment on revised closing documents should no longer be an issue. Given the breadth of the public comments

received, it does not appear that any significant issue has been overlooked. With respect to the careful coordination of changes to the documents to avoid unplanned consequences and conflicts, HUD has strived to assure clarity and consistency throughout the documents. As part of this assurance, it is HUD's intent to undertake regular, periodic review of the documents to revise and update them.

Proposed documents contain profound policy changes that have not been adequately debated

Comment: Commenters stated that the documents contain major and minor changes in policy and requirements; that there are dozens, perhaps hundreds, of changes not related to modernization. The commenters stated that certain regulations and several major closing documents are being so radically changed that successful, longstanding HUD policy and practice are being reversed with little or no justification and without apparent consideration for the practical impact on affordable housing production, lenders, borrowers, and residents. The commenters stated that there is little or no evidence that these changes are necessary to reduce the level of insurance claims and HUD's losses on claims, and that the tone created by the documents is one of great distrust. Other commenters stated that it may be the inadvertent result of trying to fit the Freddie Mac loan documents to the HUD programs, or a deliberate focus on the complete elimination of any risk to HUD without regard to the impact on the market. The commenters stated that if there is no difference between the programs of HUD and Government Sponsored Enterprises (GSEs), it could be argued there is no need for HUD programs at all.

HUD response: The programs that HUD administers must be conducted in accordance with statutory and regulatory requirements that govern such programs, and in that way HUD's programs will always differ from the lending programs offered by private entities. One of the

primary differences between HUD programs and those of private lenders is demonstrated by the opportunity for review and public comment on significant changes made to HUD programs, including changes that HUD makes after consideration of the comments before adopting changes in final rules.

While HUD studied the Freddie Mac closing documents as a current and widely-used model, HUD's revised closing documents differ from that model. Within the parameters of its statutory and regulatory mandates, HUD's goal in revising its multifamily housing closing documents is to develop forms that are consistent with existing HUD administrative policy and that are also consistent with modern lending and credit enhancement practices. The forms currently in use and that are proposed to be replaced by the revised closing documents have not been changed in any significant fashion since the 1960s. The tone of distrust perceived by some of the comments may reflect, in part, the changes in lending practices over the more than 40 years since the documents have been revised. The issue from HUD's perspective is not one of trust or distrust, but recognition of responsible practices in which the reasonable expectations of the parties are informed by the transparency of the transaction, and in which obligations and outcomes are clear.

Comment: Several commenters wrote that Fannie Mae and Freddie Mac regularly negotiate, modify, and waive certain provisions in their form documents, to tailor them to the deal at hand, and asked if HUD is equipped to negotiate these documents to any extent.

HUD response: HUD is not a lending entity and does not negotiate directly with Borrowers. However, the revised closing documents are not absolute in their requirements. The documents often make reference to actions or events that are subject to HUD approval. Some documents also contain instructions about permitted transactional changes. To that extent, the

documents provide a degree of direction with respect to modification or waiver.

Proposed documents add significant expense and administrative burden

Comment: Commenters wrote that among many new obligations, the proposed modifications would require the mortgagee to notify HUD of Regulatory Agreement violations and to review Transfer of Physical Asset requests; the proposed Security Instrument would require the borrower to provide and the mortgagee to collect extensive books, records and financial data; the proposed modifications to the Regulatory Agreement would impose new categories of actions that a borrower cannot take without obtaining HUD approval; and the proposed modifications to the Escrow Agreement impose new responsibility upon the mortgagee for approving escrow advances. The commenters stated that these additional burdens are imposed without any mechanism for compensation for the added expense and without any staffing increases at HUD. The commenters further stated that additional monitoring and processing requirements are not needed to protect or preserve the properties.

HUD response: HUD has made a deliberate effort to include, in the revised closing documents, provisions that specify the oversight and diligence that a reasonable, prudent lender would observe in the usual course of business, that reflect current policy, and that do not add significantly greater burdens. As such, HUD is not requiring extraordinary measures that impose extraordinary costs, but is only memorializing good practice in a uniform template to provide clarity of expectation and a level playing field to all lenders.

Comment: Several commenters wrote that they believed that current HUD staffing, structure, and resources are not adequate to accommodate the everyday demands and consequences of the proposed documents and regulations.

HUD response: HUD has considered that there will likely be at least an initial increase

in the demands upon its resources as a result of the revised documents and regulations, and will allocate the resources necessary to address them.

Comment: The documents lack standards for HUD staff to apply in considering various approval requests.

HUD response: HUD will apply the standards of reasonableness and good cause, as it does in considering regulatory waivers (see 24 CFR 5.110). Where more particularized standards become necessary, HUD will provide for them in handbooks or regulations, as appropriate.

Comment: Several commenters wrote that HUD insurance programs could well become solely an “option of last resort.” Increased operations oversight and regulation on unsubsidized projects will further frustrate profit-motivated owners and discourage use of the program. As the quality of the HUD portfolio diminishes, there will be a higher percentage of defaults.

HUD response: HUD does not consider that any owners will be discouraged from participating in HUD’s programs, particularly after the changes made to the revised closing documents in response to public comment. HUD expects that the resulting consolidation and simplification of requirements will not only encourage increased participation, but will result in better supervision of loans and a reduction in claims. In addition, as this preamble and changes to the revised closing documents reflect, HUD has responded favorably to numerous public comments. One of the main objections was in the area of the regulation of health-care facilities. As stated earlier in this preamble, HUD has separated those closing documents pertaining exclusively to health-care facilities from the rental housing documents for further analysis and later public comment.

Comment: Commenters stated that potential borrowers like the long-term, fixed-rate,

non-callable programs at very competitive rates and limited recourse that HUD programs offer. Commenters stated that they are willing to tolerate nontraditional costs and impediments/irritants such as annual audits, extra origination expenses, restricted profit payments, inspections by HUD's Real Estate Assessment Center (REAC), management review, and inconsistent timeliness and processing requirements. The commenters stated that advantages of long-term, fixed-rate non-callable programs will be overcome by the detrimental consequences of the proposed recourse liability for Borrowers, Principals, and yet-to-be defined Key Principals; increased liability issues; increased potential for HUD micro-management; additional duties with no further remuneration; and the opportunity to be sued more often.

The commenters stated that proposed changes will render HUD programs uncompetitive and unworkable for many Borrowers, including Low income Housing Tax Credits (LIHTCs) and nonprofit Borrowers, thereby reducing the number of new construction projects, which will drastically reduce the current job and tax base growth across the country.

HUD response: Please see the immediately preceding comment and HUD response. As discussed above, HUD has determined not to include broad recourse liability in the revised proposed closing document but has retained recourse liability for certain "bad boy acts."

Residual Receipts and nonprofit sponsors

Comment: No public purpose is served by limiting nonprofit sponsor access to project surplus cash, which discriminates against this sector and only makes nonprofit sponsor operations more confusing and problematic.

HUD response: Consistent with current practice, a nonprofit entity may elect to be treated as a for-profit entity. Nonprofits may elect to utilize certain programs that are limited to nonprofit and/or limited distribution mortgagors because of the benefits provided to such

mortgagors, e.g., 100 percent mortgages versus the 90 percent mortgages typically available to profit-motivated entities. An example of such a program is the section 221(d)(3) program (section 221(d)(3) refers to section 221(d)(3) of the National Housing Act). In section 221(d)(3) transactions, HUD must regulate such nonprofit entities to a greater extent than HUD regulates profit-motivated or general mortgagors. If, on the other hand, a nonprofit elects to utilize a program designed for profit-motivated or general mortgagors, e.g., the section 221(d)(4) program, the nonprofit would be regulated in the same fashion as the profit-motivated entity. In such instances, the nonprofit entity would be entitled to distributions under the HUD regulations. HUD has always added the caveat that nonprofits still would be subject to any Internal Revenue Service (IRS) regulations as to distributions.

HUD Directives

Comment: A theme through most of the new closing documents is the requirement to comply with HUD “Directives.” At a minimum, commenters urged that HUD expressly limit the definition of applicable Directives to those that do not conflict with regulations in effect at the time of commitment issuance and establish a protocol to ensure that any such Directives are: (a) developed with adequate notice and comment and (b) widely disseminated and published by HUD in a manner reasonably calculated to ensure that the entire HUD Multifamily Accelerated Processing (MAP) lender community, current and prospective borrowers, and the general public have affirmative notice. Commenters stated that mere posting of such proposals or changes on HUD’s website would not be sufficient.

HUD response: As discussed above under the heading of “Across the Board Changes,” HUD’s use of “Directives,” now called “Program Obligations,” is defined in a manner to address the commenters’ concerns and assure that adequate notice and comment is provided.

Definition of new terms

Comment: Several new and material terms (for example, “Directive,” “Affiliate,” and “Key Principal”) lack clear definition, which can result in uncertainty and unfairness.

HUD response: As noted in the discussion of article definitions, HUD has revised many definitions in response to the public comments received. HUD will continue to clarify the terms used, as may be necessary, in the course of HUD’s periodic review of these documents.

Exhibits to be removed from closing checklist

Comment: The following application exhibits should be removed from the HUD closing checklist, as redundant: HUD 2010; Title VI Certification; LIHTC Certification; Byrd Amendment Certification; Owner’s Certification Regarding Architectural and Engineering Fees; and Identity of Interest Certification (other than HUD-93306M).

HUD response: The HUD closing checklist was not one of the documents published in the Federal Register for notice and comment in 2004, and it is not being published under this notice for comment. This is a document that is tailored to the needs of each closing.

HUD Multifamily Security Instrument HUD-94000M

State-specific components

Comment: One commenter wrote that the necessary state-specific components of the Security Instrument also demand notice and comment. Another commenter asked if there are any provisions giving the beneficiary the right to appoint a successor trustee or requiring the borrower to receive, at the address shown in the Deed of Trust, a Notice of Default from the beneficiary.

HUD response: The state-specific components are imposed by state law, not by HUD, and are not subject to HUD’s notice and comment requirements. Similarly, the provisions that

are the subject of the commenter's inquiry are governed by state law and would be covered, as necessary, by the state-specific components.

Section 1 — Definitions

Comment: The definition of Building Loan Agreement in section 1(b) should provide that references to the Building Loan Agreement may be removed if not applicable, for example, in refinancing transactions.

HUD response: Redesignated Section 47 (section 50 in the proposed document), the only section of the Security Instrument in which the term Building Loan Agreement is used, has been qualified by adding, “(If Applicable)” to the heading of that section. Therefore, a determination of whether the section applies will be made on a case-by-case basis.

Comment: A definition should be added for “Business Day” as “any day other than a Saturday, a Sunday or any other day on which Lender or HUD is not open for business.”

HUD response: Business Day is added as a new definition at section 1(c) with a cross-reference to section 31, which includes the definition suggested by the commenter; it is the only section in which the term Business Day is used.

Comment: A commenter wrote that under section 1(c), agreements of Lenders and Borrowers that are proprietary in nature should not be included in the definition of “Collateral Agreement.”

HUD response: HUD does not agree that proprietary, or any other, agreements should be excluded from the definition of Collateral Agreement, because HUD needs to have access to all documents to understand the risk that it is underwriting. The definition of Collateral Agreement has been moved to section 1(e).

Comment: Collateral Agreement should be defined as “any separate agreement between

Borrower and Lender (excluding the Note, this Security Instrument and the Building Loan Agreement, if any) for the purpose of establishing and/or maintaining any reserves, escrows and/or funds that are required by Lender and/or HUD in connection with the Mortgaged Property (including, but not limited to, reserves, escrows and funds for repairs, replacements, improvements, off-site improvements, demolition, assurance of completion, working capital, minor moveable equipment, operating deficits, debt service reserves and/or sinking funds), as the same may be amended, modified, renewed, extended, replaced and/or supplemented from time to time.” This definition better harmonizes with the scheme of insurance closings and documentation, and it is broadened to eliminate the need to identify specifically the agreements that are captured within this definition.

HUD response: This suggested revision broadens the definition of Collateral Agreement by providing a greater number of examples of agreements that may be covered by the definition, but it also narrows the scope of the definition by limiting the covered agreements to reserves or escrows “required by Lender and/or HUD.” The current language is broader in scope in that it is “not limited to those reserves and escrows required by HUD.” The suggested revision is not consistent with the goal of full disclosure of, and approval for, all agreements executed in connection with the Mortgaged Property, which is necessary for HUD to make valid judgments about the risk it is underwriting. The original proposed language has, therefore, been retained.

Comment: A definition should be added to state, “Condemnation has the meaning ascribed thereto in section 22(a).”

HUD response: HUD believes the term “Condemnation” is widely understood and thus unnecessary to define.

Comment: A definition should be added to state, “Contract of Insurance means the

contract between the Lender and HUD whereby HUD insures the Borrower's repayment of the Loan to Lender pursuant to the National Housing Act, as amended, the Department of Housing and Urban Development Act, as amended, and all other federal laws and regulations pertaining to HUD's insurance of the Loan, all applicable Directives, and HUD's commitment to insure the Loan."

HUD response: HUD has added Contract of Insurance as section 1(g), with a cross-reference to section 3(e), which refers to the Contract of Insurance, "as set forth in applicable HUD regulations." HUD considers this long-used reference to be sufficient to identify the Contract of Insurance for purposes of the Security Instrument.

Comment: A definition should be added for "Loan means the loan made by the Lender to Borrower in connection with the Mortgaged property which is evidenced by the Note and secured by this Security Instrument."

HUD response: A definition of "Loan" has been added as section 1(u), which references "the opening paragraphs of this Security Instrument," and a parenthetical reference to Loan has been added to the opening paragraphs following the space provided for entering the principal amount of the Loan.

Comment: A definition should be added that "Loan Application" means the application for mortgage insurance made to HUD in connection with the Loan, together with all supporting exhibits, schedules, and reports.

HUD response: "Loan Application" has been added as section 1(v) with a cross-reference to the definition in redesignated section 41, No Change in Facts or Circumstances, which was section 43 in the proposed Security Instrument. This definition references the Loan Application that is submitted by the Borrower to the Lender, not the Application for Mortgage

Insurance that is submitted to HUD.

Comment: The definition of Loan Documents should include “the Building Loan Agreement, the Collateral Agreements, and any other documents executed by the Lender and Borrower to evidence or secure the Loan.”

HUD response: The definition of Loan Documents continues to be limited to “the Note, this Security instrument, and the Regulatory Agreement.” These are the only documents that HUD will permit to evidence or secure the loan. The Building Loan Agreement and Collateral Agreements relate to important aspects of the project, but the Note, Security Agreement, and Regulatory Agreement are the key documents that relate directly to the HUD-insured mortgage.

Comment: A commenter wrote that the definition of Mortgaged Property at section 1(q) (redesignated as section 1(y) in the revised document) should expressly include all deposits and/or escrows held by or on behalf of the Lender under the Collateral Agreements.

HUD response: HUD agrees, and has included escrows and deposits in the definition of Collateral Agreements as items included in the definition of Mortgaged Property at section (1)(y)(16).

Comment: A commenter wrote that in the definition of what is included in “Mortgaged Property,” section 1(q)(11), now redesignated as section 1(y)(11), must provide a carve-out of Surplus Cash and all syndication proceeds and partner contributions that are not part of the HUD insured loan.

HUD response: HUD agrees, in part, with the comment. The definition of “Mortgaged Property” is deliberately broad to make resources available in the event there is an underwriting or asset management issue. However, to address the concerns in the comment, section 13(a) of the Regulatory Agreement has been revised to provide that “Equity or capital contributions shall

not include certain syndication proceeds, such as proceeds from Low Income Housing Tax Credit transactions used to repay bridge loans from members/partners of Borrower, all as more fully set forth in Program Obligations.”

Comment: In the definition of “Mortgaged Property,” references to personal property (such as section 1(q)(11), now redesignated as section 1(y)(11)), should be moved to the definition of “Personalty”.

HUD response: HUD declines to make the suggested change. While there is some redundancy in listing individual examples of Personalty in section 1(y)(11) of the definition of Mortgaged Property, which also includes Personalty, generally, at section 1(y)(4), such repetition serves to underscore the intended wide breadth of coverage of the term “Mortgaged Property.”

Comment: A commenter wrote that in section 1(q)(14), tenant security deposits that “have not been forfeited” should be changed to “have been forfeited.”

HUD response: HUD disagrees. Tenant security deposits are funds that are held in trust on behalf of a tenant, so long as they have not been forfeited.

Comment: Borrowers should be able to exclude capital contributions receivable and syndication proceeds receivable, listed in section 1(q)(16), from the Mortgaged Property. To include these is a major policy change.

HUD response: As noted above, the definition of “Mortgaged Property” is deliberately broad to make resources available in the event there is an underwriting or asset management issue, but HUD has removed “certain syndication proceeds” from being included as equity or capital contributions.

Comment: The definition of Mortgaged Property should explicitly exclude surplus cash and related Borrower funds, which HUD has not traditionally viewed as Project funds.

HUD response: HUD disagrees. Surplus cash has always been considered part of the Mortgaged Property until it has been disbursed.

Comment: In section 1(q), a leasehold estate should be included in the definition of Mortgaged Property.

HUD response: A leasehold estate is covered by the definition of “Land” (which is redesignated as section 1(q) in this final version) as “the estate in realty described in Exhibit A” and which appears as the first item listed under the definition of “mortgaged property.”

Comment: In the definition of “Principals” at section 1(t), if, for example, the Bank of America is a 25 percent limited partner in an LIHTC project, will each vice president be a principal?

HUD response: HUD has replaced the definition of “Principals” with a cross-reference in redesignated section 1(dd) to the definition at 24 CFR 200.215(e). In accordance with the terms of the definition in the 2004 proposed Security Agreement and the definition at 24 CFR 200.215(e), only vice presidents (or other officers) “who are directly responsible to the board of directors” would be Principals. HUD intends to update the definition at 24 CFR 200.215(e) through rulemaking.

Comment: In section 1(t), the term “Principal” must be narrowed significantly to capture only those entities that have actual control over the project.

HUD response: The persons listed in the definition included in the 2004 proposed Security Agreement have authority for actual control and, therefore, are appropriately included as principals. HUD intends to update the definition at 24 CFR 200.215(e) through rulemaking.

Comment: The definition of Property Jurisdiction should be changed to read, “means the State in which the Land is located.”

HUD response: HUD disagrees with the suggested revision, because the term Property Jurisdiction is used in the context of identifying the governing law for the documents, and governing law may include both local and state laws not preempted by federal law. HUD retains the definition of Property Jurisdiction in section 32(a) (redesignated as section 30(a) in this final document) with an added clarification that both state and local jurisdictions are relevant. The phrase, “jurisdiction in which the Land is located” has been revised to read, “jurisdictions in which the Land is located” to describe more precisely, the term “ Property Jurisdiction”.

Comment: A definition should be added for Title Policy to read, “Title Policy means the policy of title insurance issued to the Lender contemporaneously with the closing of the Loan and insuring the priority of the lien of this Security Instrument.”

HUD response: The term “Title Policy” is commonly understood in the field of real property transaction, and need not be defined in this document.

Comment: Section 1(y) – The definition of “waste” is too broad, with no indication how it would be applied to Real Estate Assessment Center (REAC) scores.

HUD response: The references to “HUD requirements regarding physical condition standards for HUD housing” in the definition of “waste” are removed.

Comment: There are no appeal rights provided for findings of “waste.”

HUD response: HUD is not aware of any appeal right as an industry-wide practice with respect to Security Instrument covenant violations. Such disputes would be governed by state law.

Comment: In section 1(y), the definition of “Waste” should remove all references to financial obligations such as failure to pay taxes add a materiality standard in clause (1) add such language as “in a manner customary for similar properties in the area in which the

Mortgaged Property is located” to clause (2) and limit clause (4) to failure to comply with 24 CFR 5.703.

HUD response: A failure to meet financial obligations would impair the value of the Mortgaged Property, and must therefore be included in the definition of waste to protect HUD’s interest. A materiality standard is added for failure to comply with covenants. A reasonableness standard is added to the obligation to maintain and repair the property. HUD is removing failure to comply with HUD requirements for physical condition standards as a basis of waste.

Comment: The definition of “Waste” should be removed.

HUD response: A definition of Waste is necessary to provide all of the parties to the transaction with a common understanding of this significant term, which serves to preserve the Mortgaged Property over the term of the agreement.

Section 3 — Assignment of Rents; Appointment of Receiver; Lender in Possession

Comment: In section 3(c), imposition of personal liability is not acceptable.

HUD response: This section is not an imposition of personal liability, but a representation and warranty that there had not been a prior assignment of rents.

Comment: Section 3(c) will need to be revised in the event HUD permits any supplemental or subordinate loans (e.g., loans insured under Section 223(d) or 241).

HUD response: A revision to section 3(c) would not be necessary in the circumstances described by the comment, because the parenthetical clauses in the section provide for exceptions in the cases of assignments and collections in connection with commercial transactions as “approved by HUD.”

Comment: In section 3(d), prior written approval by HUD of actions by Lender is impracticable. A Lender must be able to move quickly to preserve its collateral.

HUD response: HUD's prior written approval to take control of the Mortgaged Property is required only in the event of a nonmonetary default. The remedy of taking control of the Mortgaged Property is not frequently exercised in the context of a nonmonetary default, and HUD must be consulted before such an extraordinary action can be taken to assure that HUD's interest is protected.

Comment: In section 3(e), to the extent that this section exonerates a Lender for negligent or intentional acts, this provision will not be enforceable, and Borrower's counsel will take exception to it in the Opinion Letter.

HUD response: Section 3(e) will be enforceable in accordance with its specific terms; otherwise, the Lender is released from liability "to the fullest extent permitted by law."

Section 4 – Assignment of Leases; Leases Affecting the Mortgaged Property

Comment: In section 4(c), the term "mortgagee in possession" should be substituted for "Lender in possession."

HUD response: HUD does not agree that the suggested change is necessary. The definition of Lender, now at section 1(s), provides that the Lender is deemed to be the Mortgagee.

Comment: Section 4(e) should be revised to contemplate cooperating housing arrangements and other instances where flexibility to permit Leases with terms longer than 2 years might be desirable by including the following language at the end: "If a Borrower is a cooperative housing corporation, association, or other validly organized entity under municipal, county, state or federal law, notwithstanding anything to the contrary herein, so long as Borrower is not in breach of any covenant of this Security Instrument, Lender hereby consents to the execution of Leases for terms in excess of two years from Borrower to tenant shareholders of

Borrower, to the surrender or termination of such leases where the surrendered or terminated Lease is immediately replaced or where the Borrower makes best efforts to secure such immediate replacement by a newly executed Lease of the same residential unit to another tenant shareholder of the Borrower. However, no consent is hereby given by Lender to any execution, surrender, termination or assignment of a Lease under terms that would waive or reduce the obligation of the resulting tenant shareholder under such Lease to pay cooperative assessments in full when due, or the obligation of the former tenant shareholder to pay any unpaid portion of such assessments.”

HUD response: The suggested revision is not necessary because of the flexibility provided in section 4(b), which states, in part: “Until Lender gives Notice to Borrower of Lender's exercise of its rights under this section 4, Borrower shall have all rights, power and authority granted to Borrower under any Lease (except as otherwise limited by this section or any other provision of this Security Instrument), including the right, power and authority to modify the terms of any Lease or extend or terminate any Lease.”

Comment: Section 4(f) should specify that the requirements for approval of nonresidential leases apply after the date of execution of the Security Instrument.

HUD response: HUD disagrees with the suggested revision. It is only a prudent business practice for the Lender and HUD to know the status of all nonresidential leases and consider whether or not they are acceptable prior to the execution of the Security Instrument.

Comment: Section 4(f) should provide that consent of the Lender and HUD to modify, extend, or terminate a lease for nonresidential use is “not required for the modification or extension of non-residential Leases if such modification or extension is required under the terms of the Lease or is on terms at least as favorable to Borrower as those customary at the time in the

applicable market and the annual income from the extended or modified Lease will not be less than the income from the Lease during the year prior to the effective date of the extension or modification.”

HUD response: HUD does not agree with the comment because the suggested revision describes the kind of considerations the Lender or HUD would take into account in determining whether to approve a lease modification, but additional considerations may also be relevant in any particular case. Determining whether or not a lease modification satisfies the conditions in the suggested revision would itself be a form of approval review. As long as the Lender or HUD would still be undertaking a review of a lease modification, it would not be prudent for HUD to exclude any relevant considerations. This is not a new requirement, and HUD is not prohibiting modifications, extensions, or renewals, only prudently requiring that HUD’s consent be obtained.

Comment: A commenter asked whether HUD intends to deny applications for mortgage insurance if an existing lease does not meet the requirements of 4(f)(1) and the lessee refuses to amend its lease.

HUD response: Generally, HUD will only approve applications that meet HUD requirements except in cases where HUD approves a waiver of a requirement.

Section 5 – Payment of Indebtedness; Performance Under Loan Documents; Prepayment Premium

Comment: A specific provision to require payment of Mortgage Insurance Premium (MIP) should be added to this section, since none of the Loan Documents specifically require it.

HUD response: HUD disagrees with the comment. Section 7(a)(1) provides for the payment of MIP.

Section 6 – Exculpation

Comment: The proposed exceptions to Owner nonrecourse liability are not acceptable.

HUD response: HUD has revised section 6 to indicate that no personal liability is being imposed on Borrower.

Section 7 – Deposit for Taxes, Insurance, and Other Charges

Comment: This section should be re-titled: “Imposition Deposits; Application of Payments; Advances by Lender for Impositions.”

HUD response: HUD does not agree that the suggested recommendation is necessary.

Comment: The amount in section 7(a)(1)(ii) should be revised to “... an amount equal to one-twelfth of ____ percent...” with the blank filled in, since the mortgage insurance premium varies by program.

HUD response: The amount in section 7(a)(1)(ii) refers to the service charge when the Note and Security Instrument are held by HUD rather than the mortgage insurance premium. This amount remains constant across FHA programs.

Section 8 – Imposition Deposits

Comment: A provision should be added that if the Note secured hereby (“Junior Note”) is junior in priority to a HUD-insured Note (“First Note”) where the First Note holder is collecting Imposition Deposits, collection of Imposition Deposits, other than mortgage insurance premium deposits on the Junior Note are waived for the period the First Note holder continues to collect such Imposition Deposits.

HUD response: HUD agrees, in part, and has clarified section 8 so there should not be confusion with respect to the right of Lender regarding any securitization of imposition deposits.

Sections 8 and 9—Lender’s payment of interest to borrower

Comment: Section 8 and section 9 both state, “unless applicable law requires otherwise,

lender shall not be required to pay borrower any interest, earnings or profits on the Imposition Deposits.” Section 11, Reserve for Replacement, of the Regulatory Agreement requires that the Reserve for Replacement “be invested in interest bearing accounts or investments, and any interest earned on the investment shall be deposited in the Reserve for Replacement for use by the Project.” This inconsistency needs to be resolved.

HUD response: To resolve this inconsistency, the phrase, “or as otherwise required by HUD,” is added following, “unless applicable law requires,” in section 8. Section 9 has been removed.

Section 9 – Collateral Agreements

Comment: Section 9 is probably superfluous in light of the provisions of sections 7 and 8, and should be removed.

HUD response: HUD agrees, and the text of section 9 is removed, with the remaining sections renumbered accordingly.

Section 10 – Regulatory Agreement Default

This section is now designated as section 9.

Section 13 – Use of Property

This section is now designated as section 12.

Comment: This provision precludes a Borrower from establishing any condominium or cooperative regime with respect to the mortgaged property, if such use did not exist at the time the security agreement was executed. The provision should be removed so that this option remains available.

HUD response: HUD has changed “Unless required by applicable law,” to “Unless permitted by applicable law,” so as not to preclude a change in use of the property, where

permitted.

Comment: This language should be changed to “Unless required by applicable law and/or approved by Lender and HUD.”

HUD response: As noted above, HUD has changed “Unless required by applicable law” to “Unless permitted by applicable law.”

Comment: Because there are certain instances in which the use of a portion of a Project may change following construction or rehabilitation, the first sentence should be qualified by adding “except as contemplated in the Loan Application.”

HUD response: HUD recognizes that in some instances the use may change, and the document allows for changes in use, but only with the approval of the Lender and HUD. HUD does not agree with the suggested revision, which would allow changes in the use of the property without the approval of the Lender and HUD.

Section 14 — Protection of Lender’s Security

This section is now designated as section 13.

Comment: Section 14(a) should refer to obligations under the Security Instrument or “any of the other Loan Documents” to expand the list of references to Loan Documents under which the Lender may seek recourse to protect its and HUD’s interests.

HUD response: HUD does not consider that including a reference to the term “Loan Documents” would provide any additional protection of a Lender’s security beyond the broad power already conferred in section 14, now redesignated section 13, which extends to any action or proceeding that purports to affect the Mortgaged Property or the Lender’s security and permits the Lender to take, with HUD approval, such actions as the Lender deems necessary. The term “Loan Documents” is defined in section 1(w) to include the Note, Security Instrument, and

Regulatory Agreement, and redesignated section 13 references the obligations under each of these documents.

Section 15 – Inspection

This section is now designated as section 14.

Comment: This section should provide for proper notice, except where there is an emergency or an Event of Default has occurred.

HUD response: HUD has revised section 15, now redesignated as section 14, to provide for inspections “upon reasonable notice.” Inspections to determine compliance will be conducted in compliance with state law, which should address such concerns.

Section 16 – Books and Records; Financial Reporting

This section is now designated as section 15.

Comment: The period for Borrower to furnish documents to Lender in section 16(b)(1) should be changed from 90 days to 120 days, to be consistent with Freddie Mac.

HUD response: HUD has determined that the 90-day period should not be changed.

Comment: The periods for Borrower to furnish documents to Lender in sections 16(b)(2) through (b)(4) should be limited to “upon Lender’s or HUD’s request, but not more frequently than quarterly unless an event of default exists.”

HUD response: HUD has not adopted the suggested revisions. It has not been HUD’s experience that requests for financial records from Borrowers have been excessive or abusive, and HUD does not anticipate or condone the development of abusive practices in the future.

Comment: The certification in section 16(c) should be “to the best knowledge of such individual.”

HUD response: HUD’s purpose and expectation is that the certification reflects an

active and critical review, more than a passive, general acknowledgement of documents, and for that reason does not adopt the suggested revision.

Comment: This section and the corresponding provisions of the Regulatory Agreement should be revised so as to be consistent.

HUD response: Such a revision is not necessary because the documents are not inconsistent. The Security Instrument is a Lender-specific document and includes provisions that directly affect only the Lender.

Comment: Requiring the Borrower to provide a list of all owners with any interest in the Borrower, directly or indirectly, is an unnecessary burden, and perhaps impossible. Consider the effect of including all the officers of a public company.

HUD response: HUD is revising this provision to require only a list of persons or entities required to be identified by HUD's applicable previous participation requirements.

Comment: Required certifications should be to the knowledge of the individual providing the certification.

HUD response: HUD does not agree with this comment. The Lender and HUD are entitled to rely upon the accuracy of the required statements, schedules, and reports, and the authorized individual is in a position, and has an obligation, to confirm and certify the accuracy of these records.

Comment: The proposed requirements go far beyond current requirements by including a statement of income and expenses for borrower's operation of the Mortgaged Property, a statement of change in financial position, a rent schedule, and an accounting of all security deposits, to be submitted to the Lender. What duties and obligations are imputed to the Lender by receipt of these documents? Such documents should be provided only upon Lender's or

HUD's specific request.

HUD response: The obligation to act in the manner of a prudent Lender is not a new requirement. The enumeration of specific documents to be provided to a Lender empowers Lenders to act prudently in performance of their contractual obligations and also does not permit Lenders to claim lack of access to pertinent information as an excuse for not performing their oversight duties. To remove any doubt and make this responsibility clear rather than imputed, the Security Instrument is revised to specify that Borrower is furnishing the documents "for review by Lender" and that Lender must report irregularities to HUD.

Comment: At the current time, there is no requirement for Borrowers to deliver any of these documents to the Mortgagee. There is no necessity to have a recourse carve-out for a process HUD has already updated by having Borrowers file audited financial statements electronically directly to HUD and that HUD already monitors with various enforcement remedies.

HUD response: While the recourse carve-out has been eliminated, the requirement to deliver documents to Lender is retained because Lenders do not have access to HUD's data.

Comment: Lender should be allowed to charge a reasonable fee for collecting and reviewing any documents.

HUD response: These activities are a normal part of servicing, and should not entail a separate or additional fee.

Section 17 — Taxes; Operating Expenses

This section has been redesignated section 16.

Comment: Sections 17(a) and 17(b) should state they are also subject to the provisions of section 8(c).

HUD response: HUD does not consider it necessary to include the reference to section 8(c) in redesignated sections 16(a) and 16(b), both of which are subject to section 16(c). Section 16(c) relieves the Borrower from the obligations imposed under sections 16(a) and 16(b) to pay impositions and expenses to the extent that sufficient Imposition Deposits are held by the Lender. Section 8(c) records the Lender's obligation to pay any bill or invoice received for an imposition from, and to the extent of, Imposition Deposits held by the Lender. The requirement that the Borrower's obligation to pay is relieved only to the extent of Imposition Deposits held by the Lender is present in 16(c), and there is no need to reference section 8(c) too.

Comment: In section 17(b), "HUD approved operating budget" should be removed, since there may not always be a HUD-approved operating budget.

HUD response: Section 17(b) in the 2004 proposed Security Agreement (now redesignated section 16(b) in the revised proposed Security Agreement) creates no difficulties, since it refers to the HUD-approved operating budget, "if any."

Section 18 – Liens; Encumbrances

This section is now designated as section 17.

Comment: Subjecting the Borrower to personal liability in the event a voluntary or involuntary lien is placed on the Mortgaged Property is unacceptable. A lien that might not be material should not automatically subject the Borrower to personal liability, and a Borrower should have the right to have personal liability removed if the new lien is cleared up.

HUD response: HUD has modified the section to remove the reference to personal liability at the end.

Comment: Inferior liens are not an Event of Default if approved by HUD and Lender. The exception should cover inferior or HUD-insured or HUD-held superior liens, because such

liens may be in existence and will continue.

HUD response: HUD agrees, and has revised the section accordingly.

Section 19 – Preservation, Management, and Maintenance of Mortgaged Property

This section has been redesignated section 18.

Comment: The Borrower should not have the obligation under section 19(c) to restore the Mortgaged Property when insurance proceeds or condemnation awards are not available to cover the costs of such restoration or repair. This is unfair and unreasonable.

HUD response: HUD determined that it is appropriate to require the Borrower to restore the Mortgaged Property in order to protect the Lender’s and HUD’s interests in the property, especially since the Borrower is in the best position to ensure that adequate and appropriate insurance remains in place. However, HUD has revised section 19(c) to provide that HUD may approve an exception to this requirement if circumstances warrant.

Comment: Section 19(e) requires the Lender to approve the property manager and management contract. Section 20 gives the Lender the right to terminate the management contract without cause. What is the purpose of giving Lender these new rights, and what standards is a Lender to apply in acting under these rights?

HUD response: Section 19(e), redesignated as section 18(e), has been revised to provide that property management approval must be “consistent with HUD management certification and/or Program Obligations.” Section 20 has been removed.

Comment: Section 19(f) requires HUD to be notified of any action or proceeding purporting to affect the Mortgaged Property. Does HUD want to be inundated with notices of evictions, spurious counter-claims, minor slip and fall claims, etc?

HUD response: HUD agrees, and in the phrase “purporting to affect the Mortgaged

Property” in redesignated section 18(f) is changed to “which could impair the Mortgaged Property” to limit the required notifications.

Comment: A commenter stated that section 19(g) provides that Borrower shall not “remove, demolish, or alter the Mortgaged Property” without HUD approval. The commenter asked whether HUD wants to be inundated with permission requests to dispose of insignificant personal property or to make minor alterations to projects.

HUD response: Section 19(g), redesignated as section 18(g), is revised to permit “minor alterations which do not impair the security.”

Comment: A commenter asked how HUD will define “reasonable and necessary operating expenses.”

HUD response: The definition of ‘Reasonable Operating Expenses’ from section I.1.bb of the Regulatory Agreement is incorporated by reference in the Security Instrument by the introductory paragraph of section 1. The document language is conformed in section 18(h) by removing “and necessary.”

Comment: Provisions in section 19 conflict with the Regulatory Agreement, and should be removed in favor of the Regulatory Agreement.

HUD response: The language “pursuant to the Regulatory Agreement” is added in redesignated section 18 as appropriate for consistency.

Section 20 – Management Contracts

Comment: If there is no Event of Default, the Lender should not have the right to terminate a management contract without cause. Provisions conflict with the Regulatory Agreement, and they should be removed in favor of the ones in the Regulatory Agreement, which make HUD the regulator of management issues.

HUD response: Due to such concerns, section 20 has been removed.

Comment: This section should be divided into section (a), a new section to require management contract compliance with the Regulatory Agreement (RA) so long as the Security Instrument (SI) is insured or held by HUD, and section (b), to consist of the current text to allow for Lender control over the property manager issues if the SI is no longer insured or held by HUD.

HUD response: Section 20 has been removed.

Section 21 — Property and Liability Insurance

This section is now designated as section 19.

Comment: Section 21(a) should cover Fixtures and tangible Personalty in addition to Improvements.

HUD response: HUD agrees that the term “Improvements” as used in section 21(a) and redesignated here as section 19(a), is too narrow for the intended purpose of ensuring adequate hazard insurance coverage. In the first sentence of 19(a), HUD has substituted for “Improvements” the term “Mortgaged Property,” which provides a wider scope of coverage and internal consistency within section 19(a), since “Mortgaged Property” was already used in the third sentence of section 19(a). The term “Improvements” continues to be used in section 19(a) as the appropriate term for purposes of flood insurance.

Comment: In section 21(b), a requirement that a Borrower deliver to its Lender the original or a duplicate original of a policy “at least thirty days prior to the expiration date of any policy” is impracticable, if not impossible. Insurers do not forward a new policy to their insured for days or weeks after renewal.

HUD response: To address the concerns raised in the comment, HUD has revised

redesignated section 19(b) by removing the requirement that Borrower deliver the insurance policy to Lender and by instead requiring the delivery of evidence of continuing coverage in form satisfactory to Lender.

Comment: Section 21(b) should specify that the Lender is named as loss payee.

HUD response: HUD agrees with the suggested revision, and redesignated section 19(b) is revised to require that the Lender, its successors, and assigns be named as loss payee.

Comment: The current policy stipulating that HUD be listed as an additional insured should be retained.

HUD response: As originally published, section 21(b) already provides that policies of property damage insurance must include a noncontributing, nonreporting mortgage clause in a form approved by Lender, and in favor of Lender and HUD, as their interests may appear. In addition to retaining this language, redesignated section 19(b) has been revised to require that the Lender, its successors, and assigns be named as loss payee.

Comment: In section 21(g), any Lender discretion to apply insurance proceeds to the payment of indebtedness or to the restoration of the Mortgaged Property must be exercised reasonably.

HUD response: The conditions in redesignated section 19(g) that limit the Lender's option to apply insurance proceeds to the payment of the indebtedness provide a standard of reasonableness for the exercise of the Lender's discretion.

Comment: Section 21(g)(2) should include language that there will be sufficient funds to pay all amounts due under the Loan Documents during the Restoration period.

HUD response: HUD does not agree with the suggested language because sufficient funds should be available in virtually all cases. In those cases where sufficient funds are not

available, Lender would exercise its options under section 19(f) to use proceeds for either Restoration or payment of the Indebtedness in accordance with Program Obligations. Generally, insufficient funds would constitute an Event of Default under section 19(g)(1).

Comment: A new section 21(g) should be added (current 21(g) to become 21(h)) to exclude HUD or Lender involvement for insurance claims arising from casualties up to \$10,000 and to allow Borrower adjustment with Lender control of proceeds for claims arising from casualties ranging from \$10,000 to \$50,000.

HUD response: HUD and the Lender may exclude themselves from involvement in particular instances, but need to do so on an informed basis because of the uncertainties that are inherent in casualty claims. For this reason, HUD declines to adopt the suggested revisions.

Comment: In section 21, language should be added to clarify that mortgage payments are still due on time regardless of any insurance adjustments and generally to require the Borrower to provide such additional documentation as may be required to account for insurance proceeds.

HUD response: There is nothing present in the document to suggest that any insurance adjustments affect the Borrower's obligation to pay the Indebtedness when due in accordance with section 5, and HUD does not consider clarification of that issue to be necessary. However, HUD is adopting the suggestion to require the Borrower to provide documentation to account for insurance proceeds and is adding to redesignated section 19(f) the sentence, "Borrower shall notify the Lender of any payment received from any insurer."

Section 22 – Condemnation

This section is now designated as section 20.

Comment: In section 22(a), language should be added that the Borrower will reimburse

and indemnify the Lender for expenses incurred or actions taken in connection with a Condemnation.

HUD response: The remedy sought by the comment is provided under redesignated section 13, “Protection of the Lender’s Security,” of the document. The expenses incurred by the Lender in connection with a Condemnation, permitted by section 13(a), would become part of the principal of the indebtedness and be immediately due and payable under section 13(b).

Comment: Section 22(b) precludes the ability of the Borrower to provide one large principal payment to the Lender in the event there is an award of compensation under a condemnation. Such payment to the Lender should be allowed.

HUD response: Section 22(b), redesignated as section 20(b), does not preclude a large principal payment in the event of a compensation award, but explicitly allows condemnation awards to be applied to installments of principal. Condemnation compensation may be applied in large principal payments and to the outstanding Indebtedness in accordance with the amortization schedule in the Note.

Section 23 – Transfers of the Mortgaged Property or Interests in Borrower

This section is now designated as section 21.

Comment: The extent of required HUD approval here greatly exceeds existing requirements, which already exceed those of Freddie Mac or Fannie Mac.

HUD response: There is essentially no change in the requirements, other than to clarify and limit the scope of actions subject to HUD approval; two additional exceptions are added to redesignated section 21: corporate restructuring mergers when there is no change in control and first user syndication prior to final endorsement of the Note by HUD. To permit additional exceptions, the introductory clause, “Unless permitted by Program Obligations,” is added to

redesignated section 21.

Comment: The list of transfers not requiring prior HUD approval should include: transfers pursuant to court decrees; leases of units in the ordinary course of business; dispositions of obsolete or deteriorated Personalty or Fixtures that are replaced by items of equal or greater quality and value; creation of mechanic's or judgment liens that are released or otherwise remedied to the Lender's satisfaction within 90 days after Borrower is notified of such lien; transfers of shares or any assignment of occupancy agreements or leases of a housing cooperative; and as otherwise specifically permitted under the Loan Documents.

HUD response: Court decrees do not require approval pursuant to section 21(c); residential leases are not subject to approval; disposition of replaced Personalty or Fixtures is permitted under section 18(g); liens are subject to approval under section 17; housing cooperatives are governed by a cooperative agreement document, which is not relevant in this document; and if an assignment or lease is specifically permitted in another loan document, the specific requirement takes precedence over the general requirement.

Comment: There should be an exception to obtaining HUD approval prior to the addition of a Principal for properties financed with LIHTCs, as currently allowed if the Principals (partners) are brought in between initial and final endorsement.

HUD response: As noted in HUD's response to a previous comment, an exception for first-user syndication prior to final endorsement of the Note by HUD has been added to section 23, now designated as section 21.

Comment: HUD has insufficient staff to handle all transfer requests.

HUD response: HUD will allocate its resources as necessary to carry out its responsibilities.

Comment: Imposition of personal liability for unauthorized transfers is not acceptable.

HUD response: References to personal liability have been removed from redesignated section 21.

Sections 24 and 45 – Two-tiered default approach will hamper ability to minimize losses and damages

Section 24 is now designated as section 22. Section 45 is now designated as section 43.

Comment: The scope of Class B, which includes any failure of Borrower to perform any of its obligations under the Security Instrument, is too broad.

HUD response: A standard of material failure of Borrower to perform any of the obligations under the Security Instrument has been added to narrow the scope of Class B Events of Default in redesignated section 22.

Comment: The distinction between Class A and Class B defaults places an unreasonable burden of oversight on the Lender, and exposes the Lender to litigation by creating a new contractual remedy for borrowers to contest the existence of any default.

HUD response: The Lender's responsibility for prudent oversight of the loan, and the exposure to litigation resulting from the exercise of that responsibility, are always present, regardless of HUD's classification of, and procedures for, Class A and Class B defaults. Lenders should have no difficulty in distinguishing between a Class A monetary default and a Class B covenant default. To underscore the intended reasonable scope of the Lender's responsibility and to emphasize that HUD's focus is not on trivial events, a standard of materiality has been added in redesignated section 22 to qualify the kind of event that would constitute a Class B default. In addition, to address the litigation concerns expressed by commenters, and to mitigate a Lender's exposure to lawsuits under the Security Instrument, the statement in redesignated

section 43, concerning a Borrower's right to bring an action to assert the nonexistence of an Event of Default, is removed.

Comment: The changes deny the Lender its longstanding right to declare a covenant default and exercise its rights under the loan documents. The Lender's leverage over the Borrower is eliminated by inability to enforce covenant defaults, and will require HUD to handle directly all covenant defaults.

HUD response: The change does not remove the Lender's right to declare and ability to handle directly a covenant default, but includes HUD, which has a substantial interest in the matter, in the decision to proceed. Because the interests of HUD and the Lender will not always coincide, HUD has determined it must assert the authority to concur in the declaration of a covenant default, to safeguard properly the public assets that HUD administers.

Comment: If HUD retains its two-tiered default scheme, Lender should be able to declare a default and exercise all remedies for all defaults that involve nonpayment that significantly threaten the security of the Lender's collateral, including failure of payment, failure to maintain clear title, and failure to maintain insurance.

HUD response: Section 22(a), which appeared as section 24(a) in the August 2, 2004, publication, defines a Class A Event of Default as, "Any failure by Borrower to pay or deposit when due any amount required by the Note or Section 7(a) or (b) of this Security Instrument within a grace period of thirty (30) days after the due date thereof." Section 43 (section 24(a) in the August 2, 2004, publication), which addresses acceleration and remedies, provides: "At any time during the existence of a Class A Event of Default, Lender, at Lender's option, may declare the Indebtedness to be immediately due and payable without further demand, and may invoke the power of sale and any other remedies permitted by applicable law or provided in this Security

Instrument or in the Note.” A default that involves nonpayment, including failure to maintain insurance, which is specifically covered under section 7(a), would be a Class A Default that permits the Lender to exercise all remedies. Failure to maintain clear title, however, does not involve nonpayment but would be a covenant default, which is a Class B Event of Default. Lender action under a Class B Default is subject to prior HUD approval.

Comment: If Lender makes an advance that Borrower does not repay, the Lender has no effective recourse.

HUD response: The Lender has effective recourse against the Borrower under sections 8(a) and 13 (previously designated section 14), both of which make sums paid or advanced by the Lender on behalf of the Borrower a part of the principal of the Note, bearing interest from the date of payment and due and payable on demand. A Borrower’s failure to repay then would be the basis for a financial, Class A default under current section 22(a).

Comment: Section 45 requiring prior HUD approval before accelerating debt contradicts the intent of 24 CFR 207.256, that mortgagee must give HUD only notice of covenant defaults, regardless of whether the mortgagee has already accelerated the loan.

HUD response: The rule at 24 CFR 207.256 addresses the notice that must be provided to HUD of a mortgagor’s failure to comply with a covenant, even if such failure does not constitute a default. The cited section does not address the question of HUD approval before accelerating debt, which section 43, previously designated section 45, requires only for covenant defaults.

Comment: HUD has not provided any criteria for approving a Class B default. Would HUD permit the Lender to foreclose on an aging property with a REAC score below 60?

HUD response: As noted earlier, HUD has added a standard of materiality for Class B

defaults. While HUD does not consider a low REAC score to be a trivial matter, HUD will consider each instance separately on a case-by-case basis in determining whether to approve a Class B default, and will create an administrative record to support HUD's decision. Among the elements HUD would consider is the record supporting the Lender's decision to accelerate the indebtedness.

Comment: It would be beneficial to provide Borrowers more opportunity than currently available to avoid potential defaults, and the period when HUD would decide whether to approve an insurance claim could provide such an opportunity. But criteria for HUD approval, established after notice and comment, are necessary.

HUD response: The requirement for HUD to approve covenant defaults would likely have the effect of providing Borrowers more opportunity to avoid potential defaults. Until experience provides a basis for HUD to formulate appropriate, generally applicable criteria, HUD will proceed on a case-by-case basis, as described above, when determining whether to approve a covenant default.

Comment: Longstanding rights of Lender, such as right to consent to junior mortgages, are essentially eliminated.

HUD response: Prior HUD approval for an encumbrance of the mortgaged property has been a longstanding requirement that is carried through into the new documents, leaving the Lender's rights essentially unchanged.

Comment: Fannie Mae and Freddie Mac models allow mortgagee discretion to declare default and accelerate the loan. Current HUD documents and Fannie Mae and Freddie Mac impart waivers and consents on the Borrower's part with respect to certain actions by the Lender, which are important protections for the lender, HUD, and the security.

HUD response: These important protections are preserved in section 43, previously designated section 45, of the Security Instrument, which leaves at the Lender's option the acceleration of the debt and any other available remedies upon a financial default. The requirement for HUD approval before a Lender may take action upon a covenant default is intended to provide additional protection, particularly for HUD and the security. Section 43 also waives, on the Borrower's part, a judicial hearing prior to the sale of the property exercised by the Lender under the Agreement and entitles the Lender to collect all costs and fees incurred in pursuing remedies.

Section 27 — Loan Charges

This section is now designated as section 25.

Comment: This section is not necessary since the Lender should be able to determine if the loan is usurious, and because the Lender and HUD require an opinion from Borrower's counsel to that effect. In rare instances where charges are usurious, the Lender should bear the consequences and the Borrower should have the right to recover costs and expenses in enforcing penalties.

HUD response: Section 25 (previously, section 27) of the Security Instrument, as well as section 13 of the Note, direct the manner in which charges are to be reduced and allocated for achieving and determining compliance with laws that limit loan charges. These sections also direct how the excess charges paid by the Borrower are to be applied in those rare instances, as the commenter acknowledges, where loan charges are usurious. As such, these provisions provide additional clarity and guidance should this rare instance occur. The provisions, however, do not address the issue of recovery of costs.

Section 29 — Waiver of Marshalling

This section is now designated as section 27.

Comment: It is inappropriate for HUD to have any input in the Lender's election of remedies following a default where the Lender has elected not to assign the loan.

HUD response: As noted previously, the interests of HUD and the Lender often, but not always, coincide. In order to protect its interests from being adversely affected by action that may be taken by the Lender, HUD insists on such action being subject to HUD's rights and requirements.

Comment: It is inappropriate to include provisions in the Security Instrument, such as section 29 (redesignated as section 27), that address the relationship between HUD and the Lender.

HUD response: HUD disagrees that such provisions are inappropriate. Including provisions in section 27 and elsewhere that make certain actions subject to requirements of or approval by HUD, which is the insurer of the Loan, is appropriate to provide notice to all the parties of such requirements.

Section 31— Estoppel Certificate

This section is now designated as section 29.

Comment: There is no limit on the number of Estoppel Certificates that can be requested. They should be required of Borrower only at reasonable intervals.

HUD response: HUD does not consider a limit on such requests to be appropriate, as a limitation would impair the rights of the Lender. HUD presumes the right would be exercised reasonably and not abused, but HUD will investigate allegations of abuse should they arise.

Comment: No Borrower can give such a certificate until the loan documents are drafted to conform and remove conflicts.

HUD response: One of the goals of publication, public review, and revision of the documents is to ensure their consistency. As discussed previously in this preamble, HUD will conduct periodic reviews of the documents and update them to maintain and improve consistency.

Section 32 — Governing Law; Consent to Jurisdiction and Venue

This section is now designated as section 30.

Comment: Section 32(b) should add language to permit Lender and HUD to bring actions in any jurisdiction.

HUD response: HUD declines to adopt this suggestion. Redesignated section 30(b), which identifies the Property Jurisdiction as the venue for bringing an action, is consistent with redesignated section 30(a), which identifies the law of the Property Jurisdiction as governing. The courts of the Property Jurisdiction are the most familiar with their own requirements and procedures and would be the most competent courts to apply those requirements and procedures necessary to resolve a controversy. Defining the governing law and venue also permits all of the parties to make plans and act on them with a reasonable expectation of how controversies will be resolved.

Comment: A new Section 32(c) should be added to include a waiver by Borrower and Lender of right to trial by jury.

HUD response: HUD declines to adopt, as a matter of HUD policy, the imposition of a jury trial waiver upon parties participating in its FHA mortgage insurance programs. This policy does not prevent parties from agreeing to such a waiver in a collateral agreement subject to HUD approval.

Section 35 – Single Asset Borrower

This section is now designated as section 33.

Comment: This is more appropriately incorporated in the Regulatory Agreement.

HUD response: HUD disagrees with this comment, because the Lender also has an interest in imposing and enforcing this provision.

Comment: Language should be added to clarify that the infusion of cash from investors is “additional property” that may be owned by Borrower and that is not subject to restrictions applying to Project assets.

HUD response: HUD does not permit any unapproved encumbrance of the Mortgaged Property. It is HUD’s long-established position that any infusion of cash, secured or not, is a project asset that is subject to withdrawal restrictions.

Section 36 — Successors and Assigns Bound

This section is now designated as section 34.

Comment: Language should be added to provide that upon assignment by Lender of its interest under the Security Instrument, Lender shall automatically be released from any and all obligations under the Security Instrument, and Borrower shall look solely to the assignee of the Security Instrument for the enforcement of any of Borrower’s rights under the Security Instrument.

HUD response: HUD does not agree that an assignment should operate as a hold harmless provision, particularly with respect to acts that are undisclosed or undiscovered at the time of assignment.

Section 38 – Third— Party Beneficiaries

This section is now designated as section 36.

Comment: Section 38(b) should be modified to make HUD a third-party beneficiary of

the Security Instrument.

HUD response: At present, it does not appear that such a requirement is necessary to protect HUD's interest in the property, particularly in light of the adoption of the revised Regulatory Agreement. Additionally, HUD is not the lender, so it is not a beneficiary of the Security Instrument. HUD will reconsider this issue periodically when reviewing and updating the documents.

Section 42 – Disclosure of Information

This section is now designated as section 40.

Comment: This provision is overly broad, since “third party” is not defined. It authorizes the Lender to give information to virtually any person.

HUD response: In addition to being limited to the extent permitted by law, the disclosures authorized by section 42 are permitted only to third parties “with an existing or prospective interest in the servicing, enforcement, evaluation, performance, purchase or securitization of the Indebtedness.”

Section 43 – No Change in Facts or Circumstances

This section is now designated as section 41.

Comment: This language should be conformed to language in the Event of Default section, or cross-referenced to that section, and must contain a materiality clause.

HUD response: Section 43, redesignated section 41, does address materiality, and requires that information be “accurate in all material respects and that there has been no material adverse change in any fact or circumstance.” As noted in the discussion of the comments that addressed section 24, a standard of materiality has been added to Class B covenant defaults.

Comment: Language should be added that qualifies Borrower's certification of facts to

be “to the best of Borrower’s knowledge.”

HUD response: HUD does not agree with this comment. As noted in the response to a similar comment on section 16, redesignated as section 15, the Lender and HUD are entitled to rely upon the accuracy of the required statements, schedules, and reports, and the individual authorized to certify to this information is in a position, and has an obligation, to confirm and certify the accuracy of these records. However, the certification is not absolute or focused on petty detail, but is qualified by a standard of materiality.

Comment: The last sentence, “The submission of false or incomplete information shall be a Class B Event of Default,” should be removed.

HUD response: HUD does not agree that the last sentence in redesignated section 41 should be removed. This section requires Borrower to certify that information submitted in, and in connection with, the Loan Application is complete and accurate in all material respects. A violation of this requirement would be a material failure of Borrower to comply with this obligation under the Security Instrument, which is included in the definition of Class B Event of Default at redesignated section 22(b)(3).

Section 45 – Acceleration; Remedies

This section is now designated as section 43.

Comment: Waiting for HUD approval could jeopardize a Lender’s security, and should not be required for Class B defaults.

HUD response: HUD approval would not jeopardize the security, but would tend to safeguard it, because HUD is also concerned with preserving the security. Increasing the options for preservation of the security is one of HUD’s motives in asserting authority to approve Class B covenant defaults.

Section 47 – Remedies for Waste

This section is now designated as section 45.

Comment: The remedies listed create confusion regarding what are, or are not, events of default, and how they are determined.

HUD response: Waste may be the basis for a default, or a remedy for Waste may be pursued independently of a default. If a remedy for Waste is sought without declaring a default, the remedies listed in section 45, now designated as section 43, such as collection of all costs and expenses, would be available in addition to the remedies specified for Waste under section 47, now designated as section 45.

Comment: Section (c) adds a very broad notion of valuation that opens the Borrower to interpretations of value, this increasing Borrower's exposure.

HUD response: HUD disagrees with this comment. Rather than broadening the notion of valuation, section 47(c), now designated as section 45(c), limits recovery of damages to the extent that the Waste has impaired the Lender's security. The effect of such a provision would be to narrow, rather than broaden, the Borrower's exposure to liability.

Section 50 – Construction Financing

This section is now designated as section 47.

Comment: Construction financing does not apply to all programs, and this section should clarify under which programs this section applies.

HUD response: Section 47 has been qualified by adding, "(If applicable)" to the heading of that section. The determination of whether the section applies will be made on a per transaction basis.

Section 51 – Environmental Hazards

This section is now designated as section 48.

Comment: Section 51(f)(2) is confusing because it requires the Borrower to warrant to the Lender that no prohibited activities or conditions exist or have existed on the site. This warranty could not be made if the Borrower has identified such activities or conditions and has remedies or plans to remedy them. Section (f)(2) should read similarly to (f)(3), which provides for previous disclosures to the Lender, and should take into account remedies.

HUD response: The concern of the commenters is addressed by the definition of “Prohibited Activities or Conditions,” which appears in section 48(b), previously designated section 51(b), and excludes “matters covered by a written program of operations and maintenance approved in writing by Lender.”

Comment: The proposed language is overly detailed. The section should provide only that: (a) Borrower will comply with all applicable environmental laws; (b) Borrower will comply with any remediation plan required; and (c) Borrower will indemnify Lender and HUD for any environmental violations.

HUD response: HUD considers the notice provided by the more detailed requirements of redesignated section 48 to be of more assistance in addressing and avoiding environmental risks that may endanger the Mortgaged Property than the very general language suggested by the commenter.

Comment: This section is overly broad and complex, and unreasonable. Substantial reworking is necessary.

HUD response: Section 48 has been revised to address such concerns. Sections previously designated 51(b)(i) and (ii), dealing with the presence, handling or transportation of Hazardous Materials on the Mortgaged Property, are removed, leaving the focus on

noncompliance with Hazardous Materials Laws or Environmental Permits. Section 48(c) now specifies that the exclusion from “Prohibited Activities or Conditions” applies to supplies customarily used in the operation of multifamily properties, and that the exclusion for petroleum products used in motor vehicles also applies to motor-operated equipment. Section 48(e) is clarified by specifying that persons who must comply with the written program of operations and maintenance approved in writing by Lender (an "O&M Program") are those “encompassed by the O&M Program.” The introductory clause of section 51(f)(3) (as previously designated), “except to the extent previously disclosed by Borrower to Lender in writing,” is removed as redundant, since the last sentence of (f)(3) refers to previous disclosures by the Borrower.

The language, “to the best of Borrower’s knowledge after reasonable and diligent inquiry,” is moved to qualify all of section 48(f)(6) and cover actions both pending and threatened. Communications of environmental, health, or safety matters subject to section 48(f)(7) are limited to those “which have not already been resolved.” Section 48(k) on Borrower’s indemnity obligation is revised to permit a transferee to assume a Borrower’s environmental obligations and to remove the provision about presence of Hazardous Materials from coverage under section 48(k) as redundant. Section 51(n)(3) (as previously designated) is removed as inconsistent with HUD’s decision to narrow the circumstances under which Key Principals are subject to personal liability.

Comment: The indemnification provision is overly broad. Out of what funds (project funds, surplus cash, others) is the Borrower to indemnify?

HUD response: The provisions of section 48(o), previously designated as section 51(o), explicitly provide that the covered indemnifications are at the Borrower’s “own cost and expense.” The funds available for indemnification are those, such as surplus funds or

distribution funds, that would be available to the Borrower after project costs have been paid.

Mortgagee's Certificate, HUD- 92434M

This document has been renamed “Lender’s Certificate.”

General Comments

Comment: The term “Mortgage” should be changed to “Security Instrument” or “Loan,” as appropriate.

HUD response: HUD agrees the language used throughout the closing documents should be consistent, and is replacing the term “Mortgage” with the term “Security Instrument.” The title of this document and usage throughout has been changed from “Mortgagee’s Certificate” to “Lender’s Certificate,” to be consistent with the change from using the term “Mortgagee” to using the term “Lender” in all of the documents.

Comment: In many places, the Certificate refers to attached documents. These documents are submitted separately at the closing, and attaching them is unnecessarily duplicative.

HUD response: The requirement to attach certain documents is the current practice, which HUD intends to continue under the revised documents. Attaching the documents may be an inconvenience initially, but is an invaluable convenience subsequently when the documents need to be consulted or if an assignment takes place.

Comment: The Mortgagee’s Certificate should be reorganized (i.e., one section should list all amounts paid to HUD, another section should list all financing charges, and all sections dealing with various escrows should be consolidated).

HUD response: HUD generally agrees with the comment and, while not adopting all of the suggested changes, had undertaken considerable restructuring from the existing Mortgagee’s

Certificate that is now being replaced by the Lender's Certificate.

Section 2

Comment: HUD should insert clarifying language to the certification in section 2 that Lender certifies only "to the best of its knowledge" that all conditions of the Commitment have been fulfilled, since many conditions (in particular "special conditions" inserted by HUD offices) are HUD's responsibility.

HUD response: HUD relies upon this certification to protect HUD's interests, and intends for Lender to have an affirmative duty to confirm that conditions have been met, consistent with its prudent servicing responsibilities. The certification has been clarified to cite specifically that all HUD-imposed work conditions have been met.

Section 3

This section is now designated as section 4.

Comment: "For all cases involving construction advances" should be removed since the Mortgagee's Certificate is only used for this type of loan.

HUD response: HUD disagrees with the comment, because the Certificate applies more broadly and is used in construction loan transactions as well as in other transactions, e.g., insurance upon completion, and refinancing.

Comment: Language that the Building Loan Agreement is between the Borrower and Lender should be added.

HUD response: HUD does not consider the suggested limiting language to be necessary.

Section 5

This section is now designated as section 6.

Comment: Rather than an extension of the title policy for each insured advance, the

alternative of current mechanic lien reports should suffice in a state where the insured loan has continued priority over liens.

HUD response: HUD finds the current practice of extending the title policy for each insured advance to be uniform and reliable regardless of specific state requirements and exceptions and for that reason will continue the practice.

Comment: For Multifamily Accelerated Processing (MAP) loans, interim advances are not submitted to HUD prior to disbursement and HUD does not approve interim advances, so language reading “if required” should be added. The same comment applies to advances under section 21.

HUD response: HUD agrees with the comment and has revised redesignated section 6 to provide that applications for insurance of advances shall be submitted if and as required. Section 21 has been revised to apply to loan advances, if required.

Comment: In the third sentence, language should be changed from “extension” to “endorsement.”

HUD response: Extension is used in a broader, generic sense in the third sentence of redesignated section 6 to cover legal obligation of the title company to insure the advance. To clarify this intent in the document, language is added to identify the referenced title policy as insuring Lender and HUD.

Comment: Language that excepts the “liens of taxes and assessments not delinquent” from the priority of the Security Instrument should be added.

HUD response: HUD agrees with the comment, and has added “tax liens not delinquent” to exceptions to the priority of the Security Instrument.

Section 6

This section is now designated as section 7.

Comment: The language, “The changes enumerated below are included in mortgage proceeds and will be disbursed by the Lender at such time as is approved by HUD,” should be changed to, “The changes enumerated below have been paid or will be paid promptly following the date hereof.” Some or all of these amounts may be paid from sources other than mortgage proceeds and not necessarily at a time approved by HUD.

HUD response: HUD agrees with the reason provided in the comment, but rather than adopt the suggested language, HUD is returning to the language of the current Mortgagee’s Certificate, which is being replaced by this Lender’s Certificate. This language, which refers to charges that have been collected in cash or will be so collected not later than the date of initial endorsement, provides a more definite time frame for payment than the term “promptly” does.

Comment: The enumerated charges are not included in mortgage proceeds but rather in the Total Estimated Development Cost.

HUD response: Consistent with the revision described in the preceding comment, HUD is removing the reference to mortgage proceeds.

Comment: Title and recording expenses should be removed, since they are costs that are not paid to or collected by Lender.

HUD response: The Lender is in the best position to collect these expenses, and this has been a longstanding HUD requirement.

Comment: Third-party contractor fees should be removed because they are typically included in the “other fees” or “organizational costs” line items in the form HUD-92264, and draws from loan proceeds to pay or reimburse third-party contractor fees must be supported by invoices. Invoices are not required to draw loan proceeds for financing charges and HUD fees.

HUD response: The Lender is in the best position to collect these expenses, and this has been a longstanding HUD requirement.

Section 7

This section is now designated as section 8.

Comment: An option to disclose a demolition escrow should be added.

HUD response: HUD has added a new subsection (iv) to section 9(a) in order to list other escrows, e.g., demolition.

Comment: This section should state that working capital deposit funds may not be used for any other purpose than in accordance with the Escrow Agreement, unless the Lender obtains the prior written approval of HUD.

HUD response: HUD has made an editorial change to redesignated section 8 to use specifically the term, “Escrow Agreement for Working Capital.”

Section 8

This section is now designated as section 9.

Comment: This section should recognize and provide for a portion of the over-and-above money that may consist of eligible costs paid by or on behalf of Borrower prior to initial closing.

HUD response: HUD does not consider it appropriate to list as escrows and deposits under the Lender’s Certificate costs paid by or on behalf of Borrower without going through Lender.

Comment: The amount of the governmental funding source escrow should be specified as 10 percent of the grant/loan proceeds being provided by the applicable governmental sources.

HUD response: HUD agrees, and the Lender’s Certificate specifies 10 percent of the

proceeds provided by the governmental source.

Comment: The offsite escrow language should be moved to section 9 with other offsite items.

HUD response: HUD considers the offsite escrow agreement, now specifically cited in redesignated section 9 as the Escrow Agreement for Off-Site Facilities, to be more appropriately included together with other escrows in section 9.

Section 9

This section is now designated as section 10.

Comment: In addition to the offsite escrow, a demolition escrow provision should be added to this section. Demolition escrows are more common than several other escrows included in the Mortgagee's Certificate.

HUD response: Neither the original Mortgagee's Certificate nor the new Lender's Certificate specifically addresses demolition activities. An additional escrow to address demolition is permissible within the scope of the Lender's Certificate, and should be listed under section 9(a)(iv) in the space provided.

Section 11

This section is now designated as section 12.

Comment: The outdated reference to bearer bonds should be removed.

HUD response: HUD agrees, and the reference to bearer bonds has been removed.

Section 14 – Reserve for Replacements Fund

Comment: The permissible investment of funds is narrower than what is currently permitted.

HUD response: HUD has revised this section to allow other investments as approved by

HUD or permitted by Program Obligations.

Comment: The Borrower should be obligated to provide IRS form W-9 and other documents required by the Lender to facilitate investment.

HUD response: HUD declines to impose the suggested requirement upon Borrower in the context of the Lender's Certificate, but Lender may independently require Borrower to provide this information without a HUD requirement.

Comment: Since Lenders often administer thousands of escrows, the Lender should have the right to approve and/or select investments.

HUD response: HUD considers it necessary to review and approve investments other than obligations of, or guaranteed by, the United States, in order to ensure that HUD's interests are protected. The investment administration experience of the Lender and the type of investment will be among the factors HUD will consider in determining whether to approve another form of investment.

Comment: HUD should specify the amount to be withdrawn, and if HUD fails to do so, the Lender should make an allocation as it deems appropriate.

HUD response: The suggested procedure is the current practice under form HUD-9250, which HUD intends to continue following.

Comment: Deposits into the Reserve for Replacement should be cash rather than U.S. Treasury securities, since there is no provision in the Regulatory Agreement that provides for the deposit of Treasury securities.

HUD response: HUD disagrees with the comment. Section 11.a. of the Regulatory Agreement specifically permits investments in Treasury securities.

Section 15 – Residual Receipts Fund

Comment: The responsibility for maintaining and administering the Residual Receipts accounts should remain with the Owner and not be shifted to the Lender.

HUD response: Section 15 does not shift any responsibility, but maintains the status quo. It has been a longstanding requirement that, with the exception of Section 202 project Owners, all project Owners are required to deposit Residual Receipts with their Mortgagees/Lenders (see, for example, Chapter 25, Residual Receipts, of Housing Handbook 4350.1, Multifamily Asset Management and Project Servicing).

Comment: Given the nature of current HUD programs, very few projects funded with new loans will likely have residual receipts accounts.

HUD response: Section 15 of the Lender's Certificate refers to cases where a Residual Receipts account is required under the Regulatory Agreement. Section 12 of the Regulatory Agreement requires Section 221(d)(3) and 231 Non-Profit, Public Body, and Limited Dividend Borrowers to establish and maintain a Residual Receipts account.

Comment: Deposits into the Residual Receipts Fund are not fixed as to amount or date, and therefore, the Lender will not know whether or not the proper amount has been received within the specified time frame. Language should be added to require the Lender to review the Project's annual financial statements and then notify HUD if a required deposit has not been made within 45 days after Lender's receipt of the annual statement.

HUD response: HUD agrees, in part, with the comment, and has added language to redesignated section 15 of the Security Instrument to provide explicitly that Lender is to review financial information that Borrower is required to provide Lender within 90 days of the end of Borrower's fiscal year. Based upon this review, Lender should be able to determine if Borrower has complied with Residual Receipts requirements. Rather than requiring Lender to report any

noncompliance of Borrower within a specific time frame, such as 45 days, section 15 of the Lender's Certificate now requires reporting of Borrower's noncompliance when known to Lender.

Comment: Language allowing withdrawals pursuant to the Regulatory Agreement without HUD's permission should be removed, since under the Regulatory Agreement, HUD's approval is required to make distributions from the Residual Receipts account.

HUD response: HUD agrees with the comment, and the reference to withdrawals pursuant to the Regulatory Agreement is withdrawn.

Comment: Language should be added permitting the investment of funds in interest-bearing investments.

HUD response: HUD agrees with the comment and has added language permitting other investments approved in writing by HUD.

Comment: The last sentence requiring notification to HUD of "any irregularity" is vague and should be removed. The Lender is already required to notify HUD of any shortfall or of any known violation of the Regulatory Agreement.

HUD response: The language of the last sentence of section 15 has been clarified by replacing the term "irregularity" with the phrase "noncompliance with Program Obligations."

Section 19 – Insurance Policies

Comment: It is inappropriate for the Lender or HUD to be named as a "loss payee" on policies other than property insurance. Such insurance as general liability, professional liability, and worker's compensation involve defending claims against the Borrower, and payments are made to claimants, not to lenders. The Lender and HUD should be included as "additional insureds."

HUD response: HUD agrees that it is not appropriate for Lender or HUD to be named as loss payees on policies other than property insurance where payments are made to claimants. The language “where applicable” has been added to section 19 to qualify the types of insurance where Lender is to be named as a loss payee.

Comment: In Housing Notice H-92-76, pertaining to “Directors and Officers Liability Insurance versus Indemnification by the Corporation,” issued September 30, 1992, HUD determined that HUD not be named as a loss payee on property insurance policies. HUD will be included as a payee on settlement checks if it is named as a loss payee, and obtaining HUD endorsement of settlement checks is an unnecessary burden on the Borrower, the Lender and HUD staff. Naming HUD an insured is contrary to current HUD policy and would imply HUD’s participation in the inspection and funding of claims.

HUD response: HUD agrees with the comment, and HUD has been removed as a loss payee under section 19.

Section 20 – Financing Charges

Comment: Language should be added based on HUD’s existing policy set forth in the Map Guide at section 12.1.6.D.3c, to reflect that most loans made today are “unitary loans.”

HUD response: HUD does not consider any additional language to be necessary to take into account the cited policy.

Comment: The circumstances in which Lender may impose administrative fees and charges should be expanded, since the greater burdens on Lender should appropriately be passed on to Borrower.

HUD response: HUD does not consider the revised documents to impose any additional obligations upon Lender that are over and above current obligations and that would not be

ordinarily exercised in the prudent conduct of Lender's business.

Comment: Section 20(e) should be amended to reflect that costs of issuance are not collected by Lender, but paid by Borrower from loan proceeds or other funds.

HUD response: In order to better protect HUD's interest, HUD wants all costs of issuance to pass through Lender. To clarify this intent, HUD has added language to section 20(e) to provide that Lender not only collects, but also distributes from loan proceeds amounts to cover the costs of issuance.

Comment: Sections 20(h) and (i) are unnecessary and should be removed.

HUD response: The subsections in section 20 are to be checked and completed as they are applicable to the transaction. As noted previously, the full disclosure of financing arrangements that HUD seeks is necessary to protect HUD's interests.

Section 23 – Letter of Credit

Comment: The requirement that Lender notify an Issuer that its letter of credit might be drafted is unnecessary and potentially gives the Issuer an excuse not to do what it is otherwise legally required to do.

HUD response: HUD agrees with the comment and accordingly is removing section 23(d).

Comment: The Lender should have the right to negotiate with the sponsors and others for recourse against parties other than Borrower if the issuer of a letter of credit fails to fund, and reference to “any sponsor, the general contractor or the architect” should be stricken.

HUD response: HUD's intention is to ensure the availability of an unconditional, irrevocable letter of credit and for that reason it does not agree with the comment.

Section 24 – Extension of election to assign

Comment: The language in this section is not consistent with the proposed change to 24 CFR 207.258.

HUD response: HUD agrees with the comment, and section 24 is revised to refer to procedures set forth in the Contract of Mortgage Insurance. HUD plans to make a conforming change to 24 CFR 207.258.

Comment: “Participation certificates” should be included in this section to clarify that this commonly used arrangement is subject to § 207.258.

HUD response: HUD considers the current language of section 24 to be broad enough to encompass the arrangement described in the comment.

Section 26

Comment: The language should be changed to state that no portion of the amounts included in the Loan for the Borrower’s attorneys’ fees has been paid to the Lender or its employees.

HUD response: HUD agrees with the comment, and language has been added to section 26 to address the concerns raised.

Section 27

Comment: Language should be added that would limit the certification to funds “except as disclosed in this Certificate (for example, funds held in connection with a tax-exempt bond transaction to satisfy rating agency requirements)” and held “by or at the order of Lender.”

HUD response: HUD agrees in part with the comment, and has added language to limit the certification to all funds, escrows, and deposits specified in the Certificate and any and all other funds held by or at the order of Lender in connection with the Loan transaction covered by the Certificate.

Section 28

Comment: There is no reason to restate in the Mortgagee's Certificate HUD's requirements related to components stored off-site. Advances for this purpose are extremely rare.

HUD response: HUD considers it appropriate to include in the Lender's Certificate those requirements that apply specifically to the Lender, such as those referred to by the commenter.

Section 29 – Changes in Forms

Comment: The process described in this section is cumbersome and confusing.

HUD response: HUD does not consider the requirement to attach a memorandum listing changes and modifications to the documents to be overly burdensome. The listing of items that are not considered to be changes and modifications is intended to make the process even less burdensome, but if there is any uncertainty or confusion as to whether any particular item is a change, the simple resolution is to err on the side of inclusion. HUD must control the form and consistency of the documents to present a level playing field to applicants for insurance and to protect HUD's interest.

Comment: The effective date of each form should be included to provide a basis for determining the version of each document that was used.

HUD response: Although HUD does not consider the practice recommended by the comment to be necessary, because whatever documents are used will comprise the loan package for any particular transaction, each form will include the paperwork approval expiration date. The paperwork approval must be renewed, generally every 3 years, and the documents will include the new expiration date following each renewal. The latest version of HUD documents

will be available from HUD on HUD's official website (www.hudclips.org or a successor location to that site).

Comment: Language relating to “no changes” made to HUD’s form documents should be replaced with whether “material changes” have been made to such documents.

HUD response: HUD does not agree with the comment. HUD considers the listed exceptions (filling in blanks, attaching exhibits or riders, deleting inapplicable provisions, or making changes authorized by applicable Program Obligations) to what is included in changes and modifications that must be approved by HUD to provide more specific and definite guidance than the use of the term “material changes.”

Comment: All material changes in the documents should be identified by the use of type styles and strike-through that allow all parties to easily identify changes.

HUD response: HUD agrees that all changes, with the exceptions noted in section 29, must be identified, but does not consider it necessary to specify the method of identification.

Comment: An Exhibit should be attached to the Lender’s Certificate that would contain a list of all HUD closing forms and indicate for each form: (1) whether or not the form has been submitted and (2) whether or not there have been material changes to the form.

HUD response: HUD has no objection to Lender preparing a list as described in the comment, but HUD does not require and will not accept such a list.

Section 30 – Lender Violation Notification to HUD

This section is now designated as section 33.

Comment: Lender faces a risk of violating this provision if it does not report a possible violation that is unclear, or Lender may be liable to the Borrower if the Lender reports a possible violation if it turns out not to be one.

HUD response: Lender is required to report only the facts and circumstances that appear to be violations, consistent with prudent servicing responsibilities. HUD, not Lender, makes the determination of whether or not a violation is actually present.

Comment: A Lender should be required to advise HUD only of material, uncured violations of the Regulatory Agreement by a Borrower. Does HUD want to know if a replacement reserve deposit is not received on the first day of the month if it is received by the 15th day?

HUD response: The comment appears to assume more responsibility than the requirement is intended to impose. Upon receiving Lender's report of the facts and circumstances noted by Lender, HUD will make the determination of whether a violation is present, and whether it is material. There is currently a reporting requirement in place for delinquencies, which is not changed by this section.

Comment: Lender is not a party to the Regulatory Agreement and should not be responsible for reporting violations to HUD.

HUD response: While Lender is not a Regulatory Agreement party, as noted in the comment, the Regulatory Agreement is incorporated into the Security Instrument, to which Lender is a party. It is within the ordinary course of Lender's responsibility to monitor its Borrower, and Lender has greater contact with Borrower and knowledge of Borrower's activities than HUD. If, in the course of its routine monitoring and contact with Borrower, Lender becomes aware of acts or omissions that do not appear to conform to the Regulatory Agreement, HUD expects Lender to advise HUD of the situation so that HUD can take appropriate action.

Comment: Lender staff should not be expected to know and understand the complex and extensive legal obligations of the Borrower and, if applicable, the lessee. It is possible that

the Lender's servicing staff may be aware of the facts that constitute a violation, but not know that those facts constitute a violation.

HUD response: HUD expects that Lender staff is at least familiar with the terms of the documents that underlie Lender's transactions and protect Lender's interests, and would recognize issues that could be referred to more expert Lender staff for additional consideration and guidance.

Comment: What is HUD's capacity to respond to such notices?

HUD response: HUD intends to respond to such notices as appropriate, considering the materiality and magnitude of any violations determined to be present. A pattern of repeated violations, even if relatively minor, could draw HUD's attention for closer monitoring and identification and correction of systemic problems.

Section 31 – Lender Review and Approval of Transfer of Project

This section is now designated as section 34.

Comment: HUD does not currently require Lenders to review and consent to such transfers, and does not provide reimbursement for expense of such activity. HUD should permit a set fee (Fannie Mae and Freddie Mac allow \$3,000) or remove the requirement.

HUD response: Rather than a set fee, HUD is permitting Lenders to recover the costs of conducting a review. Redesignated section 34 also provides that Lender may not unreasonably withhold approval of the transfer, with the implication being that Lender could and would withhold approval as a part of prudent servicing practices. HUD considers the recovery of costs for the exercise of prudent servicing to be more than reasonable.

Comment: Lender should be able to require that the Borrower provide a deposit to cover Lender's processing fee and out-of-pocket expenses; otherwise, a lender will have no way to

collect amounts due if a transfer does not go forward if the Lender cannot condition its review on receipt of a deposit.

HUD response: HUD disagrees with the comment because redesignated section 34 specifically permits Lender to require Borrower to reimburse Lender for expenses incurred in connection with reviewing the transfer, and there is no prohibition against a reasonable deposit for this purpose.

Comment: The transfer requirements do not fully address Lender concerns, particularly with respect to filing UCC financing statements; UCC searches; and tax compliance (e.g., IRS form W-9). The Lender should have the right to impose reasonable conditions for approval.

HUD response: HUD agrees that Lender should have the right to impose reasonable conditions for approval, and for that reason, this section provides only that Lender will not unreasonably withhold approval of the transfer. This provision leaves the door open for the imposition of reasonable conditions for approval.

Comment: Parties should be permitted to use existing documents to avoid materially harming the Transfers of Physical Assets market and the value of existing insured projects, raising the possibility of “takings” challenges by borrowers.

HUD response: HUD considers it necessary to update the closing documents, and has not observed any significant objection to the general proposition of making the documents more reflective of current practice, as opposed to objections to only certain changes. With the revisions being made to the new documents, such as revising the provisions dealing with personal liability of Key Principals, the concerns expressed by the comment should be mitigated.

Comment: Where loans are in lockout, the significantly more burdensome requirements of the new forms could preclude transfers altogether.

HUD response: HUD has revised the documents, as noted above, making them less burdensome, and does not expect the concern raised by the comment to materialize.

Certification

Comment: It is unreasonable and unfair to require Lender to certify to the truth, accuracy, and completeness of the statements and representations contained in the “supporting documentation” – which is an undefined term. The certification should be affixed to specific items or the specific items should be identified. This language could be viewed as making the Lender responsible for the statements and representations of others.

HUD response: HUD agrees with the comment, and the reference to “all supporting documentation” is replaced with the more focused and appropriate, “all documents submitted and executed by Lender in connection with this transaction”.

Regulatory Agreement, form HUD-92466M

Introductory Provisions

Comment: It appears that the Regulatory Agreement is to be used in lieu of, or in addition to, Use Agreements in varying transactions.

HUD response: The Regulatory Agreement would not be used in lieu of Use Agreements, but Use Agreements could be used to supplement the Regulatory Agreement.

Comment: In the type of Borrower required to be listed in the introductory provisions, “individuals” are omitted, although referenced later in the document.

HUD response: Individuals would clearly fall under the type of Borrower listed as “Profit-Motivated” in the introductory provisions. The list of the types of Borrowers in the introductory provisions should not be confused with the definition of Borrower, which is found in section 1.b. The definition in section 1.b. applies to “all persons or entities identified as

Borrower in the first paragraph of the Security Instrument,” and encompasses individuals. If the Borrower is an individual, the striking of the “organized and existing under the laws of” language in the first section of the Security Instrument would be a permissible deletion of an inapplicable provision consistent with section 29 of the Lender’s Certificate.

Comment: The “Date of Note” line should be removed, since the information is included in the definition of “Note” in section 1.

HUD response: The line is not being removed. It is important to reference the Note in section 1 with particularity because the Regulatory Agreement is incorporated into the recorded Security Instrument.

Comment: The line requiring recordation information for the Security Instrument should be removed. It is nearly impossible to get this information inserted in each deal as the Security Instrument and Regulatory Agreement are taken to the recorder’s office at the same time for simultaneous recording.

HUD response: This line has been removed.

Comment: All limited dividend entities are not alike and cannot be treated in this document as though they are.

HUD response: To address this comment, the definition of Limited Dividend Borrower, originally at section 1.o. but redesignated here as section 1.q., has been broadened to apply to both limited dividend and limited distribution entities.

Comment: The Regulatory Agreement is stated to ensure compliance with the National Housing Act, although it also deals with Section 8 contracts and requirements of the United States Housing Act of 1937.

HUD response: The introductory provisions refer to compliance with the requirements

of the National Housing Act and any related legislation, which would certainly include the relevant provisions of Section 8 of the United States Housing Act of 1937. Further, section 42, originally designated section 29, requires Borrower to comply with all applicable laws, not only with the National Housing Act. Article IX of the Regulatory Agreement contains additional provisions that are applicable to Projects for which Borrower has entered into a Section 8 Housing Assistance Payments Contract.

Comment: It is stated that this document stays in place as long as HUD is “obligated to protect rights of tenants of the Mortgaged Property.” It is not clear why HUD would attempt to keep the regulatory agreement in place upon payment of the FHA loan. Are the requirements meant to apply where HUD vouchers are used after a loan is paid off? HUD’s stated purpose to protect the tenants is not well founded. Use Agreements may offer protections.

HUD response: HUD agrees that HUD is obliged to protect tenants under Use Agreements and other appropriate legal authority independent of the Regulatory Agreement. The reference to that obligation has been, accordingly, removed from the Regulatory Agreement.

Comment: It is stated that violations could cause the Borrower and “related parties” to be subject to adverse actions. The document can be enforced only against parties to it.

HUD response: HUD agrees that the Regulatory Agreement can be enforced only against parties to it. The definition of Borrower at section 1.b. includes successors, heirs, and assigns, which are the “related parties” that are contemplated in the introductory provisions. The unnecessary reference to “related parties” in the introductory provisions has been replaced with “other signatories.”

Comment: The document does not provide for waiver, amendment, appeal of decisions, or evidence of authority on the part of HUD personnel.

HUD response: The authority of HUD personnel is provided in Delegations of Authority. The Regulatory Agreement does not preclude amendment and, in fact, section 42 (originally section 29), Compliance With Laws, refers to compliance with all subsequent amendments, revisions, promulgations, or enactments of, among other items, covenants and agreements recorded against the Mortgaged Property. Appeal of decisions, which HUD takes to mean an appeal of a HUD denial of an approval required under the Regulatory Agreement, is not provided.

Comment: The introductory items should include lines for “Project Name” and “Project Location.”

HUD response: The suggested changes have been made.

I. Definitions.

Definition of “Affiliate”

Comment: The reference to post-debarment entities is particularly opaque.

HUD response: The definition of Affiliate in the 2004 proposed Regulatory Agreement, including the reference cited in the comment, is consistent with, and is commonly understood within the context of, the definition of Affiliate at 24 CFR 180.905, a section of the governmentwide system of debarment and suspension that is adopted in HUD’s regulations at 24 CFR part 24. The revised Regulatory Agreement now cross-references the definition in 24 CFR 200.215(a), which HUD intends to update through rulemaking.

Comment: It is unreasonable to qualify a person as an affiliate merely for sharing facilities or equipment with another. The ability to control must be a factor.

HUD response: HUD agrees that the ability to control is the decisive factor. While sharing facilities or equipment can be an indication of control, merely sharing facilities with no

other indicia of control would not lead to a conclusion that control is present.

Comment: The definition of “Affiliate” should explicitly exclude non-HUD projects, because HUD should not have the right to control or otherwise to restrict property that is not financed with HUD-insured loan proceeds.

HUD response: HUD must have the right to control all security property, as well as property owned by the mortgagor entity (and other affiliated parties) that affects the security property, in order to protect the interests of HUD.

Definition of “Borrower”

Comment: HUD can define “Borrower” as broadly as it wants, but this document cannot bind anyone who has not executed it.

HUD response: As noted previously, HUD agrees that the Regulatory Agreement can be enforced only against parties to it.

Distribution – Definition at Section 1.e.; Procedure at Section 15

This section is now designated as section 1.f.

Comment: The definition of “Distribution” includes control over the distribution of “any asset of the Borrower,” while the current Regulatory Agreement refers to “any assets of the project.” The long-recognized FHA distinction between “project assets and expenses” and nonproject assets and expenses should be maintained.

HUD response: Section 42, formerly section 29, Compliance with Laws, specifically requires Borrower to comply with the Security Instrument. Redesignated section 33 of the Security Instrument, formerly section 35, requires Borrower, as a single asset Borrower or a natural person, to maintain the assets of the Mortgaged Property in segregated accounts until the Indebtedness is paid in full. In addition, under redesignated section 33, Borrower, if not a natural

person, shall not acquire any real or personal property other than the Mortgaged Property and personal property related to the operation and maintenance of the Mortgaged Property and shall not own or operate any business other than the management and operation of the Mortgaged Property. The single asset Borrower requirement is a longstanding FHA requirement that does not provide the basis for any meaningful distinction between project assets and expenses and non-project assets and expenses where Borrower is not a natural person. HUD does not intend to restrict disbursements of non-project assets of a Borrower who is a natural person.

Comment: Since it includes control over the distribution of “any asset of the Borrower,” this definition constitutes a major policy change. There has always been a distinction between project assets and nonproject assets.

HUD response: Please see the immediately preceding HUD response.

Comment: This definition is inconsistent with section 5 in the proposed new Surplus Cash Note, which permits payments from sources other than project income or assets.

HUD response: Section 15.a. of the Regulatory Agreement provides that no Distribution shall be made or taken from borrowed funds. However, section 16 provides that any advances made by Borrower, on behalf of Borrower, or for Borrower, must be deposited into the Project account. Under section 16, if such advances are used for Reasonable Operating Expenses, the advances may be reimbursed, with interest, from Surplus Funds and such repayment is not considered a Distribution.

Comment: The new definition excludes “payments of expenses that are determined by HUD to be reasonable and necessary.” HUD has replaced an objective standard with its own subjective standard, and it is no longer sufficient for an expense to be reasonable.

HUD response: In response to the comment, HUD has replaced the “reasonable and

necessary” language with the defined term “Reasonable Operating Expenses,” which has been redesignated as section 1.bb.

Comment: In the definition of “Distribution,” “any asset of the Borrower” should be “any asset of the Project.” There does not appear to be any reason why nonproject assets such as capital contributions should be limited.

HUD response: It is necessary to use the words, “any asset of the Borrower,” to protect the interests of HUD.

Comment: In the definition of “Distribution,” “payment of expenses that are determined by HUD to be reasonable and necessary expenses” should be changed to “payment of reasonable expenses.” Requiring HUD approval replaces management’s decision on running the project with a decision by HUD, and “reasonable” is a sufficient standard without the additional requirement of “necessary.”

HUD response: As noted previously, the defined term “Reasonable Operating Expenses” is now used. It is necessary to provide HUD with this control to protect the interests of the government.

Definition of “Elderly Project”

Comment: The definition of Elderly Project should be revised to read “designed for occupancy by a single person 62 years of age or older or a household whose primary occupant is 62 years of age or older.”

HUD response: HUD has decided to address policy considerations related to Elderly Projects separately and, consequently, has removed the definition from the Regulatory Agreement.

Definition of “Fixtures”

Comment: This definition is broader than under any state’s law, and, therefore, probably is not usable.

HUD response: The definition of “Fixtures” has been revised to quote the definition provided in Article 9 of the UCC.

Comment: In the definition of “Fixtures,” the word “including” should be replaced with “which may include, but is not limited to.”

HUD response: HUD agrees and has made this change and a conforming change in the Security Instrument.

Definition of “HUD”

Comment: In the definition of “HUD,” “Secretary” should be replaced with “Federal Housing Commissioner.”

HUD response: In the interest of consistency, all references are to the Secretary of HUD rather than to heads of component entities that comprise HUD and that act pursuant to delegations of authority from the Secretary.

Definition of “Leases”

Comment: The definition of “Leases” should include language stating that the term “Leases” does not apply to a lease of the Land to Borrower on which Improvements will be constructed.

HUD response: A parenthetical has been added to the definition of “Leases” to make the suggested clarification.

Definition of “Mortgaged Property”

Comment: A leasehold estate should be included in the definition of “Mortgaged Property.”

HUD response: A leasehold estate would be included in the Exhibit “A” description of the estate in realty required under the definition of “Land.” Land, in turn, is included in the definition of Mortgaged Property.

Comment: This definition seems unrelated to use of the term later in the document and therefore is very confusing as to what “funds,” for example, are being addressed in given situations.

HUD response: The term Mortgaged Property is broadly defined, and its usage in a particular context determines which aspects of the broad definition are being addressed.

Comment: Subparagraph (6) of the definition of Mortgaged Property should begin with the phrase, “all insurance policies covering the Mortgaged Property and all payments and....”

HUD response: HUD agrees in part with the suggested language and has made a revision to include language covering “all insurance policies.”

Comment: In the definition of “Mortgaged Property,” subsection (8) should provide for agreements for “use” in addition to “sale.”

HUD response: The “for use” wording would permit subleasing, which is contrary to HUD policy.

Comment: Is subsection (8) of the definition of “Mortgaged Property” intended to include a lease of the Land to Borrower under the 207 Lease addendum?

HUD response: Yes, the definition covers any estate in realty. See the definition of “Land.”

Comment: In the definition of “Mortgaged Property,” subsection (9) should include language that proceeds include both non-cash proceeds and cash proceeds.

HUD response: HUD agrees and has the revised definition.

Comments: In the definition of “Mortgaged Property,” subsection (11) should include the words, “...commodity accounts, commodity contracts, deposit accounts, other funds, receipts, any rights to payments evidenced by chattel paper....”

HUD response: This change was not deemed necessary because the definition should be adequate to cover all security property.

Comment: In the definition of “Mortgaged Property,” subsection (11) should include the words, “and escrows required by HUD.”

HUD response: Such escrows are covered by the definition.

Definition of “Non-Profit Borrower”

Comment: In section (q), there is no mention of the tax status of the organization. HUD should use 501(c)(3) in the definition of “Non-Profit Borrower.”

HUD response: In this context, HUD does not rely upon or examine the federal tax status of an organization, and is not required to do so. The principal factor in HUD’s consideration is the absence of self-interested financial profit or gain in the purposes of an organization. While federal tax status may demonstrate the presence of this factor, such status also requires many elements of technical compliance that are beyond HUD’s purview. An organization formed under, and acting in compliance with, a state’s nonprofit organization statute could qualify as a nonprofit for purposes of HUD’s program, even though the organization may not have section 501(c)(3) status.

Comment: This definition is contrary to longstanding HUD policy and section 8.12.E of the MAP Guide that permit nonprofit entities to be treated as “for profit” so long as they have not received benefits from HUD due to their nonprofit status.

HUD response: The definition does not prevent a nonprofit organization from electing

to be regulated as a for-profit organization by HUD in programs not restricted to nonprofits. Such an election would require compliance with all of the requirements applicable to a for-profit organization.

Comment: In the definition of “Non-Profit Borrower,” HUD should not change its present policy of treating a legally organized nonprofit entity as a for-profit, if it receives no benefits due to its nonprofit status, if it signs a for-profit Regulatory Agreement and otherwise subjects itself to all HUD for-profit requirements. Such a nonprofit sponsor should also be entitled to Surplus Cash distributions to affiliate companies.

HUD response: The definition only applies to nonprofits that use the nonprofit status to qualify for HUD program eligibility. In other words, if the HUD program requirement is that the mortgagor be a nonprofit entity to be eligible, then the definition is applicable to that entity. The policy of permitting nonprofit entities to operate projects as general mortgagors, public mortgagors, or for-profit mortgagors is not changed. Such nonprofit entities would be entitled to distributions; however, any IRS restrictions would continue to be applicable. The definition does not need to be changed.

Comment: In “Non-Profit Borrower,” the use of the term “minimally” preceding “the entity may not make Distributions to any individual member or shareholder” is not clear.

HUD response: HUD agrees and the word, “minimally,” has been replaced with the words, “at a minimum.”

Comment: The language, “The payment of salaries or other fees for services performed to ex-officio members shall not be subject to the provisions of this Agreement other than as a normal operating expense of the Project” should be added at end of the definition of “Non-Profit Borrower.”

HUD response: As HUD understands the comment, the suggested policy change would be contrary to long standing HUD policy prohibiting the payment of salaries and fees to such individuals.

Definition of “Personalty”

Comment: The definition of “Personalty” should include inventory.

HUD response: Inventory is included in the definition of Personalty.

Comment: “Land or the Improvements” in the definition of “Personalty” should be replaced with “Mortgaged Property.”

HUD response: HUD does not agree that such a circular reference would be helpful.

Comment: The definition of “Personalty” should include certificated securities, certificates of letter, chattel paper, documents, electronics chattel paper, general intangibles, financial assets, investment property, letter of credit, negotiable instruments, promissory notes, security accounts, securities, security certificates, security entitlements, tangible chattel paper, uncertificated securities, unrestricted cash, and investments derived from the Mortgaged Property.

HUD response: HUD agrees in part with the comment and has added investments to the definition.

Definition of “Principals”

Comment: If this definition is set in the Regulatory Agreement, it will be out of sync with previous participation requirements, thus causing confusion.

HUD response: The definition of Principals in the 2004 proposed Regulatory Agreement is not out of sync with previous participation requirements, but is based directly on form HUD-2530, Previous Participation Certification, which has been in use for a significant

period of time. The revised proposed Regulatory Agreement now cross-references the definition at 24 CFR 200.215(e), which HUD intends to update through rulemaking.

Comment: The defined term “Principals” should be changed to “Principals of the Borrower” to reflect the actual usage of this term in this particular document.

HUD response: All principals involved in the operation of the security property are covered by the term “Principal.”

Comment: The term “natural persons” in the definition of “Principals” should be qualified by “who have the authority, acting individually, to control or contractually to bind the Borrower.”

In the definition of “Principals,” the 25 percent limited partner threshold should be changed to “greater than 50%,” the phrase, “in the case of public or private corporations or governmental entities,” should be followed by the phrase “any officer or director who has the authority, acting individually, to control or contractually to bind the Borrower;” the 10 percent stockholder interest threshold should be replaced with “greater than 50%,” and the 10 percent governance interest and the 25 percent financial interest thresholds following “members or partners” should be replaced with “who have the authority, acting individually, to control or contractually to bind the Borrower, as well as each member or partner with an interest in the Borrower greater than 50%.”

It is unreasonable to hold individuals, particularly limited partners, responsible for the acts of the Borrower if they do not have any say over costs and events outside their control. Passive investors will not want to expose themselves to liability beyond their equity investment.

HUD response: Because these are matters controlled by the 2530 regulations (24 CFR part 200, subpart H – Participation and Compliance Requirements) and Program Obligations,

the suggested changes have not been made.

Definition of “Project”

Comment: This definition includes assets not traditionally included in the definitions of “project” and “project assets.”

HUD response: The definition, by its own terms, applies only to assets used in, owned by, or leased by, the Borrower in conducting the business on the Mortgaged Property. Assets unrelated to the business conducted on the Mortgaged Property are not affected by the definition.

Comment: The definition of “Project” should read: “Project means the Land and the Improvements on the Mortgaged Property.”

HUD response: The suggested change is not being made because it would be too restrictive. The policy of HUD is to include all property, as indicated in the definition.

Definition of “Reasonable Operating Expenses”

Comment: The meaning intended by the language that Reasonable Operating Expenses “must benefit the project more than the owner” is not easily understood. There needs to be clarification, to prevent HUD from using it to suit its purpose from time to time.

HUD response: The definition of Reasonable Operating Expenses is not changed from the definition in use for a substantial period of time, and is based on case law. See United States v. Frank, 587 F.2d 924, 927 (8th Cir. 1978); Arizona Oddfellow-Rebekah Housing, Inc. v. United States, 125 F.3d 777 (9th Cir. 1997); United States v. Coleman, 200 F.Supp.2d 561 (E.D.N.C., 2002); United States v. Schlesinger, 88 F.Supp.2d 431 (D. Md. 2000). Courts have reviewed many types of project expenditures and decided whether or not they are Reasonable Operating Expenses, and HUD will follow the guidance provided in such decisions in its review of particular disbursements.

Comment: In the definition of “Reasonable Operating Expense,” the use of the term “everyday” is unclear. What if the expense is required only once or twice in any given period?

HUD response: HUD agrees with the comment and has dropped the word “everyday.”

Definition of “Rents”

Comment: This definition includes assets not previously included, and inclusion of items not within the common meaning of rents is inappropriate and misleading.

HUD response: The definition of Rents is intended to specify, to a greater degree, all of the miscellaneous items of value that accrete to the mortgaged property and that are not specified elsewhere.

Definition of “Residual Receipts”

Comment: The definition of “Residual Receipts” should be removed. There does not appear to be any underwriting or business purpose necessitating different standards based on form of ownership. Nonprofits should have same privileges as proprietary sponsors.

HUD response: HUD rejects the comment, because the longstanding policy of HUD is to regulate distributions of nonprofit entities. The definition does not represent a change from present practice.

Additional Definitions

Comment: A definition for “Construction Contract” should be added, to read “means the form of the Construction Contract approved by HUD for the Project; provided such term is applicable only to those transactions for which HUD has issued a Commitment to Insure Upon Advances.”

HUD response: HUD agrees in part with the comment and has revised section 6 to read: “...Construction Contract, as approved by HUD.” With this modification, a definition is

unnecessary.

II. Construction

Comment: A provision should be added to remove this section for loans that do not involve new construction or substantial rehabilitation.

HUD response: It is clear by its own terms that this section would not apply for loans that do not involve new construction or substantial rehabilitation.

Comment: A provision should be added to allow deletion of this section as appropriate.

HUD response: HUD disagrees with the comment. Many of the provisions of the section could be applicable to a refinancing transaction where there is something less than substantial rehabilitation. Furthermore, refinancing transactions are specifically excluded where appropriate by specific language.

Section 2 – Construction Funds

Comment: Construction funds and operating funds are to be kept separate, but there is no definition of either term, and no definition of funds (such as syndication proceeds) that might not logically fall into either category.

HUD response: Construction funds include mortgage proceeds and other funds budgeted for the hard and soft costs of construction of the project.

Comment: In section 2, Construction Funds, the Borrower does not hold the Construction Funds, so what is the purpose of this provision? The entire section should be removed.

HUD response: Construction funds is not a defined term; however, the context makes the meaning clear, that the Borrower is to use funds disbursed to the Owner for construction expenses and not to commingle or place such funds in the operating accounts of the Project.

Section 3 – Unpaid Obligations

Comment: “Final closing” is an undefined term.

HUD response: HUD has clarified the point at which the unpaid obligations requirement is triggered, by specifying it is upon final endorsement of the Note by HUD.

Section 4 –Lender’s Certificate

Comment: It makes no sense for the Borrower to be bound by various provisions of the Mortgagee’s Certificate. The Borrower has no control over the Mortgagee’s actions.

HUD response: This section has been revised to refer to those terms of either the Lender’s Certificate or the Request for Endorsement of Credit Instrument & and Certificate of Lender, Borrower and General Contractor, as applicable, insofar as the applicable document establishes or reflects rights and obligations of Borrower. As noted, the Mortgagee’s Certificate in now entitled “Lender’s Certificate.”

Comment: The last two lines of this section after the word “Certificate” should be removed. A borrower cannot certify as to a future event controlled by some other entity; such certification fails to take into account either instance where Lender applies the funds for different purposes or where HUD approves a different use of such funds in the future.

HUD response: HUD agrees in part with this comment and has revised section 4 to clarify that the obligation only relates to rights and obligations of the Borrower.

Section 5 – Construction Commencement/Repairs

Comment: This provision excludes a “refinance” but not transfers of physical assets and other nonconstruction activities.

HUD response: Section 5 is a construction-related provision, and addresses only early start issues that arise in the construction context. The nonconstruction activities described in the

comment are beyond the scope of this section.

Section 6 – Drawings and Specifications

Comment: Neither “construction contract” nor “drawings and specifications” are defined terms. To add requirements to the Regulatory Agreement that do not parallel the construction documents (Building Loan Agreement, Construction Contract) is unnecessary and will lead only to confusion and paralysis.

HUD response: To clarify the consistent use of the terms pointed out in the comment, the phrase “as approved by HUD” is added following Construction Contract. The Drawings are to be identified in accordance with Article 2.A. (6), and the Specifications are to be identified in accordance with Article 2.A. (5), of the Construction Contract as approved by HUD.

Comment: In section 6, Drawings and Specifications, the term “Construction Contract” in this section needs to be defined.

HUD response: The Construction Contract is a closing document and goes hand-in-hand with the other construction documents and the industry and users are familiar with the document based upon decades of use. To provide additional clarity, the phrase “as approved by HUD” has been added following “Construction Contract.”

Section 7 – Required Permits

Comment: It must be clear that permits are not required to the extent that jurisdictions do not require permits for certain activities.

HUD response: HUD considers the modifier “all necessary,” as applied to permits in section 7, to be self-explanatory.

Section 8 – Outstanding Obligations

Comment: This section should be revised to accommodate leasehold estates.

HUD response: A leasehold estate is an obligation that is subject to HUD approval. Leasehold estates would be covered in section 8 under the “except those approved by HUD” language. There is no reason to change this section to provide such an exception, because such an agreement obviously would have been approved in writing by HUD. A sentence has been added to section 8 that, “All contractual obligations of Borrower or on behalf of Borrower with any party shall be fully disclosed to HUD.” In addition, HUD has added the following parenthetical sentence to the definition of “leases” in the Regulatory Agreement: “(Ground leases that are security for the loan are not included in this definition.)”

Comment: With respect to section 8, Outstanding Obligations, “Land” in this section should be replaced with “Mortgaged Property.”

HUD response: It is clear from the construction-related context of the section that the use of the term “Mortgaged Property” would be inappropriate.

Comment: Section 8 needs reworking. This section should be construction-related only.

HUD response: It is clear that this section is construction-related only. Therefore, changes to address the comment are not necessary.

Section 9 – Accounting Requirements

Comment: “Receipts and disbursements” may not be the correct term for what is required here, and brings up the question of whether more than project funds are covered.

HUD response: “Receipts and disbursements” is the correct phraseology. During the construction period, upon initial occupancy and through the cost certification cutoff date, the borrower does cash accounting of the rental receipts and operational disbursements, and any excess of receipts over disbursements offsets construction costs.

Comment: In section 9, Accounting Requirements, the following language should be

inserted at end of section 9: “Such funds can either be used to reduce the insured loan amount, or, with HUD’s approval, deposited into surplus cash or reserve for replacement accounts.”

HUD response: The suggested change is contained in the well-known and universally followed HUD cost certification requirements. It would be inappropriate to repeat those requirements in this section.

Section III – Financial Management

Section 11 – Reserve for Replacement Fund

Comment: Currently, only Section 223(f) projects require a reassessment of the reserve every 10 years. Is this an intentional change in policy?

HUD response: Yes, HUD is adopting this now-common industry practice, consistent with prudent servicing, to be applicable to all Borrowers.

Comment: This section purports to put certain requirements on Lenders, who are not party to this agreement.

HUD response: Section 11.a. of the Regulatory Agreement reflects section 14 of the Lender’s Certificate, which provides Lender must require a monthly deposit with Lender or in a depository satisfactory to Lender. The wording of section 11.a. has been revised to provide that the Reserve for Replacement shall be deposited with Lender, rather than held by Lender, to reflect the fact that Lender is not a party to the Regulatory Agreement.

Comment: No one will use FHA financing for new construction if the Regulatory Agreement is deemed to give HUD control over investment funds.

HUD response: The requirement to obtain HUD’s written approval in order to invest Reserve for Replacement funds in forms other than insured deposits, obligations of the United States, or obligations guaranteed by the United States, is a current requirement for FHA-insured

financing. The Regulatory Agreement does not give HUD control over investment funds, but merely provides for HUD's approval, in order to ensure that the Reserve for Replacement is not put at risk.

Comment: The "contract of mortgage insurance" should be defined in a meaningful way as opposed to saying, "Read the regulations."

HUD response: The contract of mortgage insurance will vary in accordance with the section of the National Housing Act and the implementing regulations under which the insurance is authorized. For that reason, the contract of mortgage insurance is defined by reference to the relevant regulations.

Comment: HUD's ability to increase the monthly deposit must be subject to some standards, not be left as an unappealable arbitrary decision.

HUD response: This amount is determined by a formula and is covered by the FHA insurance commitment and Program Obligations.

Comment: HUD should be able to approve alternative "amounts" in the funds, as well as "methods."

HUD response: HUD is able to approve alternative amounts, as specifically provided in the last sentence of section 11.b., and HUD may allow alternative methods pursuant to section 11.a.; for example, investments other than those federally guaranteed under section 11.a.

Comment: In section 11(b), a letter of credit should be permitted for funding the account.

HUD response: The policy of HUD is not to permit the use of letters of credit to fund the Reserve for Replacement, because mortgaged proceeds are used for the initial funding of the Reserve for Replacement. Allowing a letter of credit to fund the Reserve for Replacement could

create a windfall for the mortgagor.

Comment: Section 11(b) should provide that in the case of section 223(f)/223(a)(7) projects, the deposit is made at initial/final endorsement of the Note.

HUD response: The deposit is required at endorsement of the Note. Since there is only one endorsement for refinancing transactions, the suggested change is not necessary.

Comment: Section 11(b) should allow the cost of the written analysis required every 10 years to be paid with funds on deposit in the Reserve for Replacement.

HUD response: HUD agrees that the requested concept is reasonable and can permit the payment from the Reserve for Replacement. The Regulatory Agreement permits Borrowers to request the prior written approval of HUD on a case-by-case basis for this procedure.

Comment In section 11(c), to clarify that there is no change in Lender's statutory rights to set the interest per 12 U.S.C. 1715w(i)(2)(B), language should be added that Lender has no obligation to obtain any particular rate of return on the investment of funds, and shall not be liable to Borrower for any losses incurred in connection with the investment of funds.

HUD response: The Lender is not a party to the Regulatory Agreement and such a provision would be inappropriate therein.

Comment: A paragraph 11(f) should be added to provide that upon termination of this Agreement, any requirement to fund the Reserve for Replacement fund will terminate and the monies shall be returned to the Borrower, provided the Borrower is not otherwise required to retain the fund under any other contract with HUD.

HUD response: Upon termination of the Regulatory Agreement, HUD does not control these assets. It is not necessary for HUD to specify what is to be done with assets of the project once HUD's control is removed.

Section 12 – Residual Receipts

Comment: A deposit of residual receipts required at the time of a semiannual distribution is unheard of.

HUD response: It is a current and ongoing requirement that, if a surplus is declared on a semiannual basis, a deposit must be made at that time as well.

Comment: Consistent with the comments on the definition of “Residual Receipts,” section 13 should be removed and the discriminatory Residual Receipt limitation eliminated, or this section should be made applicable only if a nonprofit or public body mortgagor uses the benefits of nonprofit underwriting.

HUD response: HUD disagrees with the suggested major change to current HUD policy, which is longstanding and designed to protect the interests of HUD.

Section 13 – Property and Operation; Encumbrances

Comment: HUD must clarify if the deposit requirements apply to the proceeds (equity) from an LIHTC transaction. There should be a distinction between the equity required to keep the mortgage loan in balance and all other equity belonging to the property.

HUD response: HUD agrees and has clarified this section to indicate that equity or capital contributions shall not include certain syndication proceeds, such as proceeds from LIHTC transactions used to repay bridge loans from members/partners of Borrower, all as more fully set forth in Program Obligations.

Comment: HUD must define “Project Property.” If this is meant to capture all of the Borrower’s funds, FHA financing is finished.

HUD response: In response to the comment, HUD has removed the term “Project” from the caption of section 13, leaving the heading as “Property and Operation; Encumbrances,” to

avoid the confusion that may be suggested by use of the undefined term.

Comment: In section 13(a), the reference to the deposit of receivables should be removed, because receivables cannot be deposited in a bank.

HUD response: HUD agrees in part with the comment in that receivables cannot be deposited so the section now reads: "...rents and other receipts of the project..."

Comment: The word "necessary" should be removed from "reasonable and necessary expenses" because this term is too subjective and causes too much intrusion into the mortgagor's management of the project.

HUD response: As noted previously, the defined term "Reasonable Operating Expenses" is now used.

Comment: The phrase "for the benefit of the Project" should be added at the end of section 13(a).

HUD response: HUD disagrees with the comment because inserting the suggested language could cause considerable confusion and conflict regarding interpretation of the phrase, "for the benefit of the Project."

Comment: Whose delinquent taxes are referenced in section 13(d)?

HUD response: It is not relevant to whom the delinquent taxes are a liability. Such expenses cannot be charged to the project.

Section 14 — Security Deposits

Comment: This section requires the Borrower to pay interest on security deposits, which is in conflict with current HUD policy, which imposes no requirement beyond state law.

HUD response: There has been no change in HUD policy on this issue. Section 14(b) only provides for interest-bearing accounts only "to the extent required by State or local law."

Comment: It is unnecessary for the Borrower to acknowledge that the unauthorized use of security deposits “may” constitute theft and is prosecutable. This is a state law issue and should not be inserted gratuitously into this Agreement.

HUD response: HUD agrees with the comment and has removed the last sentence of section 14, which is the sentence that contained the statement noted.

Section 15 — Distributions

Comment: The reference in section 15.c. to whoever receives funds needing to return the funds to the Project would not affect persons not bound by the document.

HUD response: There is no change here from current requirement, which imposes a constructive trust upon Distributions made improperly. Borrower should seek the return of the funds.

Comment: Injecting what a Borrower “should have known” in section 15.b. adds to the muddle about the clarity and legal effect of Directives. If Distributions are not to be taken, there should be clear standards, not whether the Borrower “should have known.”

HUD response: HUD considers the “due care” standard for what a Borrower “should have known” as a basis for suspending Distributions under section 15.b. to be in keeping with longstanding practice and to be a reasonable standard, particularly when the standard is applied to a failure to provide necessary services that Borrower is required to provide. To the extent that Program Obligations apply, they will clarify the extent of Borrower’s obligation and responsibility.

Comment: In section 15.d., the second sentence should be revised to read, “All such Distributions to Section 220 (if so regulated), Section 221(d)(3) and 231 Limited Distribution Borrowers in any one fiscal year shall be limited to an amount approved by HUD that is not less

than 6 percent on the initial equity investment... .”

HUD response: HUD agrees in part with the comment, and has revised the second sentence of section 15.d. to refer generally to Limited Dividend Borrowers. Rather than specify 6 percent as the minimum distribution, HUD has left the percent as a blank, to be completed in accordance with market conditions at the time the Regulatory Agreement is executed.

Comment: Prohibiting distributions is problematic and unduly punitive when the Borrower receives a nonpassing REAC score and HUD has not performed a second inspection. A provision should be added requiring HUD to inspect within 60 days and, if not, allowing distributions.

HUD response: HUD’s multifamily inspection procedures are governed by the regulations in subpart P of 24 CFR part 200. HUD’s time frame for reinspection is determined in part by the response time of the owner in addressing repairs and deficiencies and HUD’s subsequent scheduling of reinspections into the framework of regularly scheduled inspections. HUD’s intention is to complete reinspections in a timely manner.

Comment: In section 15.b.i, what does the phrase “should have known about” mean and what standard will HUD use to make this determination?

HUD response: HUD believes the language is clear that a due care standard will be applied and has made no change.

Comment: Section 15.c. requires action from parties that do not execute this document or otherwise may have no privity with HUD.

HUD response: This provision is deliberately broad to maximize the ability to recover funds in cases of equity skimming, fraud, etc., for example by imposing an obligation on the Borrower to attempt such recovery.

Comment: The limitation on Distributions to nonprofits in section 15.d. should be removed to reflect the argument that nonprofits should have the same rights as proprietaries.

HUD response: Although minor changes have been made for purposes of clarification and to provide HUD some flexibility with respect to the permissible percentage, the longstanding HUD policy of restricting distributions will be continued.

Section 16 – Reimbursement of Advances

Comment: This section appears to prevent such customary transactions as reimbursing an employee for purchasing miscellaneous, minor items; reimbursing a management company for funds advanced to pay employees; or other recurrent problems of short-term advances needed to make required payments in advance of rent collection day or when Section 8 or other subsidy money is delayed.

HUD response: HUD disagrees with the comment. Section 16 does not prohibit such transactions but only requires advances to be deposited in the Project Account prior to being paid out, rather than being used to make payments directly. This requirement provides an accurate accounting for advances and does not constitute a change from current practice. Under section 16, repayment of advances is not considered a Distribution and may be done on a monthly basis with HUD approval. The requirement for prior HUD approval of repayments other than through reimbursements from Surplus Cash at the end of the annual or semiannual period is an important control and is HUD's longstanding practice.

Comment: Is interest on advances permitted?

HUD response: Yes, interest on advances is permitted with the prior written approval of HUD, and a sentence specifying this provision has been added to section 16.

Comment: The term “project account” should be defined.

HUD response: HUD sees no need to define project account, because any advances referenced in section 16 could conceivably be made to one of several Project accounts, which are specified in several places in the Regulatory Agreement. See, for example, the definition of “Personalty.”

Section 17 – Identity of Interest

Comment: HUD has previously not objected to a “captive” mortgagee controlled by the principals of a mortgagor, but now would prohibit such a relationship under section 17. Section 223(a)(7) projects are not covered in the MAP Guide, yet some local offices are applying the MAP Guide to all insured projects, including 223(a)(7). May a local office prohibit a mortgagee from making loans to a non-MAP Guide project owner having an identity of interest with the Lender?

HUD response: HUD has determined to withdraw the identity-of-interest provisions of section 17 for further consideration.

Section 18 – Financial Accounting

This section is now designated as section 17.

Comment: It is unclear what an “undocumented expense” is.

HUD response: An “undocumented expense” is an expense without sufficient documentation that provides reasonable identification of the basis of the expense. The term includes not only expenses for which there is no documentation, but expenses for which the documentation is in such unspecific, general terms that the basis of the expense cannot be reasonably determined; for example, a notation for “services rendered” or for “supplies received.” This definition has been added to the Regulatory Agreement.

Section 19 – Books of Management Agents

This section is now designated as section 18.

Comment: If a manager manages 50 properties of which only one is HUD related, what books must be open to HUD?

HUD response: The response to the comment is provided in the first sentence of redesignated section 18, which addresses only books and records “as they pertain to the operations of the Project.”

Section 20 – Annual Financial Audit

This section is now designated as section 19.

Comment: What happened to the small project exception?

HUD response: Small projects are required to submit annual financial statements, but they are not required to be audited. HUD has added the qualifier, “subject to Program Obligations.”

Comment: What type of Borrower certification is required?

HUD response: Borrower certification is included in the electronic Multifamily Financial Management Template currently in use.

Comment: Can Borrower’s auditor also audit an upper-tier investment partnership or fund?

HUD response: The Borrower’s Auditor needs to follow prudent accounting standards and practices. In every instance, the auditor must be guided by American Institute of Certified Public Accountant (AICPA) standards.

Comment: The sentence limiting the Borrower’s relationship with the certified public accountant (CPA) should be removed. Many elderly housing providers use their CPAs as consultants, limiting their activities could be harmful to sponsors and ultimately more expensive

to Borrowers as they go to other firms for managerial and consulting services that historically have been provided by their auditors. This limitation could also disproportionately affect smaller, unsophisticated Borrowers.

HUD response: This HUD restriction is consistent with the AICPA standards, which do not permit a consulting CPA to work also as an auditor for the same entity.

Comment: The list of items (“equipment, buildings, plans, offices, apparatus, devices, books, contracts, records, documents, and other papers and instruments”) following “Mortgaged Property,” which must be maintained and are subject to HUD examination, should be removed.

HUD response: HUD disagrees with the comment, because some of the listed items could conceivably fall outside of the definition of “Mortgaged Property.” For example, HUD sometimes requires a lender to impose collateral security mortgages upon additional properties of a mortgagor and sometimes permits a Lender to release a portion of the Mortgaged Property pursuant to the partial release of security procedures. Books and records could be located in such released property.

Section IV – Project Management

Section 21 – Preservation, Management, and Maintenance of the Mortgaged Property

This section has been redesignated as section 20.

Comment: What does the requirement that there be “no deterioration” mean? Is normal aging excluded?

HUD response: HUD agrees that the reference to “no deterioration” was too broad, and redesignated section 20(a) now requires only that Borrower “shall not commit Waste.” A definition of Waste has been added to section 1.mm. of the Regulatory Agreement, which conforms to the definition of Waste in the Security Instrument.

Section 22 – Flood Hazards

This section is now designated as section 21.

Comment: One can insure for flood hazards only if the insurance is available.

HUD response: HUD agrees with the comment. Redesignated section 21 is clarified by adding that an area must be identified by the Federal Emergency Management Agency, or successor agency, as having special flood hazards. If the Improvements are located in such an area and flood insurance is not available, the Loan will not be insured by HUD.

Section 23 – Management Agreement

This section is now designated as section 22.

Comment: Currently, HUD relies on the Management Certification and does not review or approve management agreements. Does HUD now intend to review and approve such agreements to determine acceptability?

HUD response: Redesignated section 22 is revised to clarify that there is no requirement for the agreement to be approved in writing by HUD.

Comment: The undefined term “Management Certification” should be replaced with “HUD form of management certification regarding such agreement and other management requirements.”

HUD response: HUD agrees in part with the comment and has revised that portion of the section (now designated section 22) to read, “...management certification meeting standards consistent with Program Obligations.”

Section 24 – Acceptability of Management of the Mortgaged Property

This section is now designated as section 23.

Comment: Giving HUD the right to replace the management agent is a change from

existing HUD policy, which provides such a right only if there is a default. What standards will HUD employ in making these decisions?

HUD response: HUD disagrees that there is a change from existing HUD policy. Failure to conform the Project to HUD's overall management policies consistent with Program Obligations, as stated in redesignated section 23 of the Regulatory Agreement, would constitute a default under section 18, "Preservation, Management, and Maintenance of Mortgaged Property, of the Security Instrument." HUD is linking the remedy of replacing the management agent only to the appropriate basis of default, rather than to any default. The current management agent's certification, form HUD-9839-C, contains an acknowledgement that HUD has the right to terminate the management agreement for failure to comply with the provisions of the management agent's certification or "other good cause." Evaluation criteria for a management agent are detailed in HUD Handbook 4381.5, The Management Agent Handbook.

Section 25 – Termination of Contracts

This section is now designated as section 24.

Comment: This section gives HUD the right to direct termination of all third-party vendor contracts without penalty and without cause upon 30 days, notice. This is a significant intrusion into Borrower's operation of the project, without any clear benefit to HUD.

HUD response: This section is linked to redesignated section 23, which gives HUD the right to replace management for failure to conform the Project to HUD's overall management policies consistent with Program Obligations. HUD must be able to direct the termination of third-party vendor contracts in order to ensure acceptable overall management of the Project, and redesignated section 24 provides notice of the requirements that Borrower must include in its contracts to allow HUD to do so.

Comment: This section includes no standards for HUD to apply in making decisions.

HUD response: HUD requires Borrower to include termination provisions in management and vendor contracts to allow HUD to act as necessary to protect Project assets and the public investment in the Project. HUD will make its decisions on a case-by-case basis while establishing an administrative record of its actions to demonstrate HUD is not acting in an unreasonable or arbitrary manner.

Comment: The language authorizing HUD to require termination of a contract with “any third-party vendor” and not just the managerial agent is an unjustifiable intrusion into the Borrower’s right to operate the Project and should be removed. It creates enormous potential contract liabilities for the Borrower and HUD, and a HUD termination right would make such contracts more costly.

HUD response: This power of HUD to require Borrower to terminate third-party contracts is long standing policy and necessary to protect the interests of HUD.

Section 26 – Contracts for Goods and Services

This section is now designated as section 25.

Comment: Is there a difference between “amounts customarily paid” and “costs not in excess?”

HUD response: HUD has revised redesignated section 25 to make it more internally consistent. Costs, amounts, and terms are linked to the reasonable and necessary level customarily paid in the vicinity of the Land, and the reference to “costs not in excess” has been removed.

Comment: This section, requiring HUD approval of all betterments and Improvements will place a tremendous burden on HUD and is an unjustifiable intrusion into the Borrower’s

right to operate the project.

HUD response: HUD will dedicate the resources necessary to carry out its responsibilities under the revised closing documents. HUD considers such prior approvals to be justifiable and necessary for HUD to meet its obligations of preserving the public interest in Projects.

Comment: This would change the current standard of “not exceed the amount ordinarily paid” with the unreasonable “at the lowest possible cost.”

HUD response: HUD agrees that “lowest possible cost” will not always result in reasonable expenditures for goods and services and has removed the reference to “lowest possible cost” removed.

Comment: The meaning of “betterments” should be defined.

HUD response: The term “betterments” is now qualified by language that states, “as defined in the Property Jurisdiction,” to clarify the policy of HUD.

Section 28 – Tenant Organizations

This section is now designated as section 27.

Comment: Tenants may sue Borrowers, but not HUD, and Borrowers may not join HUD to any lawsuits brought by tenants. This is unreasonable and unnecessary and should be removed. How are tenants, who are not a party to the Regulatory Agreement, precluded from suing HUD for anything?

HUD response: HUD is removing the second section of redesignated section 27, which contains the provisions identified by the comment.

Section V – Admissions and Occupancy

Section 31 – Lease Term

This section is now designated as section 29.

Comment: Exceptions should be permitted with HUD's prior written approval to accommodate displaced persons, corporate units, etc.

HUD response: The prohibition against transient housing, meaning rental for any period less than 30 days, is required by Section 513 of the National Housing Act (12 U.S.C. 1731b), and HUD has no authority to permit exceptions.

Section 32 – Commercial (Nonresidential) Leases

This section is now designated as section 30.

Comment: Borrower should not be required to seek HUD pre-approval. As long as there is no use restriction violation, Borrowers should be permitted to maximize the property's utility.

HUD response: The commercial use limitations in redesignated section 30 follow existing HUD practice, which reflects HUD's interest in prudent management of the Project. A sentence has been added to require Borrower to deliver an executed copy of the commercial lease to HUD.

Section 33 – Subleases

This section is now designated as section 31.

Comment: The Regulatory Agreement does not bind tenants. How can the Regulatory Agreement do more than require a Borrower to enforce the lease?

HUD response: The Regulatory Agreement does not bind tenants directly, but requires Borrower to include certain provisions in leases that are then enforceable against tenants by Borrower. Redesignated section 31 does not require Borrower to do more than include the specified provisions in the lease and enforce the lease.

Comment: Corporations have rented apartments to employees for short periods in section 221(d)(4) transactions. The proposed language would no longer permit this.

HUD response: As noted earlier, the prohibition against transitory housing is statutory under Section 513 of the National Housing Act. Although the comment is not precise as to the duration of the “short periods” involved, a period of less than 30 days would not be permitted under the statutory provision.

Section 35 – Section 231 Projects

Sections 34, 35, 36, and 37 have been combined into a single, revised section 32 entitled “Tenant Selection/Occupancy.”

Comment: This section and section 36 should be stricken.

HUD response: The general reference to complying with all HUD regulations and Program Obligations in selecting tenants for Section 231 Projects in the previous version of section 35 has been replaced with the more specific provisions of redesignated sections 32c and d, which are longstanding provisions in the Regulatory Agreement. Section 32c states that at least 75 percent of the units in a Section 231 Project shall be designed for elderly persons, unless HUD gives its written approval for a lesser number of units. Redesignated section 32d requires all advertising for Section 231 Project rentals to reflect a bona fide effort by Borrower to obtain occupancy by elderly persons. The previous section 36 has been replaced by redesignated section 32a and is discussed in more detail under the comment heading dealing with section 36 – Families with Children.

Section 36 – Families with Children

Comment: The Regulatory Agreement should not prohibit discrimination against otherwise eligible applicants with children for admission to elderly units. Section 3.2.L. of the

MAP Guide specifically allows for housing that is intended exclusively for the elderly, as do the Fair Housing Amendments Act of 1988, Section 542 of the Housing and Community Development Act of 1992, and 24 CFR 266.220.

HUD response: Redesignated section 32.a. clarifies the scope of the previous section 35 and provides that Borrower shall not, in selecting tenants, except for units designated for elderly persons in a section 231 Project, discriminate against any person or persons by reason of the fact that there are children in the family.

Comment: As written, this section would also appear to apply to loans insured under Section 231 of the National Housing Act, which conflicts with discussions held with the Department.

HUD response: Redesignated section 32a excludes Section 231 from the prohibition against discrimination because there are children in the family.

Comment: There is no statutory or regulatory basis for this provision as it would apply to the Section 221(d)(4), 223(f), 223(a)(7) and 231 programs.

HUD response: Except as noted for the section 231 program and as permitted by the Housing for Older Persons Act, which amended the Fair Housing Act, tenants may not be selected on the basis of whether they are families with children. (See 42 U.S.C. 3604.) Revised redesignated section 32 clarifies that the prohibition applies, except as provided in the Fair Housing Act and otherwise approved in writing by HUD.

Comment: This change requires notice and comment rulemaking, with a title and description that clearly state the intent of the proposal. The legal consequences of the consolidation and updating of forms are different from the consequences of imposing new occupancy requirements.

HUD response: These provisions, which have been the subject of the current notice and comment rulemaking, have been revised merely to restate current law.

Comment: The refusal of FHA to provide mortgage insurance for loans on elderly housing properties will significantly restrict the supply of affordable elderly housing.

HUD response: It is not HUD's intent to refuse mortgage insurance for elderly housing, as demonstrated by HUD's revision of the Regulatory Agreement's occupancy requirements.

Comment: This provision may call into question the legality of Regulatory Agreements for existing elderly housing communities.

HUD response: As noted above, the provision has been revised to restate current law consistent with Regulatory Agreements for existing elderly housing communities.

Comment: This section should provide, "Except in the case of a project specifically designed exclusively for the elderly or insured under Section 232."

HUD response: As noted previously, HUD has adopted the exclusion for projects designed for the elderly. This Regulatory Agreement does not apply to nursing home projects with financing insured under Section 232.

Section 38 — Rents

This section is now designated as section 33.

Comment: The method of rent approval depends on the program.

HUD response: HUD agrees with the comment. The provisions of redesignated section 34 are conditioned on the regulation of rent by HUD. References to a specific program are not included, so as to provide flexibility for the Regulatory Agreement to be used in different programs.

Section 39 – Charges for Services and Facilities

This section is now designated as section 34.

Comment: There is no reason for HUD to use this document to attempt to have a blanket prohibition of charges that leases and house rules may permit.

HUD response: This section does not have a blanket prohibition, but applies only if the Project is subject to regulation of rent by HUD, as is intended to avoid distortion of the HUD-approved rents by the imposition of additional charges.

Section 40 – Prohibition of Additional Fees

This section is now designated as section 35.

Comment: This section is more appropriate in the healthcare context and not applicable to apartment projects. Regardless, the Borrower should not be prohibited from charging credit check or criminal background fees, pet fees, deposits or other fees or charges common in the rental marketplace and tailored to a particular purpose.

HUD response: HUD agrees in part with the comment and has reworded the section to limit the section to those “certain” described fees originally iterated in the section. A sentence has been added to redesignated section 36, “Security Deposits and Other Fees,” so that the additional fees indicated in the comment can be charged. HUD does not agree that the section should appear only in the healthcare regulatory agreement as seems to be the suggestion. Founder’s fees, admission fees, etc., could be charged in connection with elderly projects, as well as for health care facilities.

Section VI – Actions Requiring the Prior Written Approval of HUD

Section 42 – Actions Requiring the Prior Written Approval of HUD

This section is now designated as section 37.

Comment: Individually and collectively, the powers reserved by HUD may create

potential HUD liability to Borrowers and third parties, due to the extensive nature of the controls HUD would have.

HUD response: HUD disagrees that requiring HUD approval would create any HUD liability to Borrowers or third parties. Borrower is placed on notice of, and agrees to, the requirement of HUD approval in the Regulatory Agreement, and would act in disregard of such requirement at Borrower's, not HUD's, peril. Similarly, Borrower's acts with respect to third parties with knowing disregard of the HUD approval requirement would not create any HUD liability to third parties. In addition, HUD approval does not constitute a guarantee of Borrower's obligations to any party. HUD's primary concerns in determining whether or not to provide any required approval are the prudent management and preservation of the Project, so as to protect HUD's interests, and HUD will not provide approvals for acts and obligations that would jeopardize those interests.

Comment: This section includes 13 separate categories of actions that Borrower shall not do without prior written approval by HUD. Will HUD have the staffing to accommodate promptly the large number of expected requests? These requirements constitute an overwhelming workload for HUD.

HUD response: As noted previously, HUD will commit the resources necessary to fulfill its responsibilities.

Comment: These requirements constitute a massive increase in HUD's involvement in Project operations and impose controls far greater than Fannie Mae, Freddie Mac, or any other lender.

HUD response: The remaining approvals required under redesignated section 37 are generally consistent with current HUD requirements, rather than a "massive increase in HUD's

involvement.” HUD has determined not to impose broad recourse liability on Key Principals and considers it necessary to require prior written approvals, as provided in redesignated section 37.

Comment: These requirements suggest a complete lack of trust or confidence in a Borrower’s ability to operate its own Project. While some of these controls may be appropriate during the existence of an Event of Default, these controls simply are not workable.

HUD response: HUD considers the comment’s emphasis on trust and confidence to be misplaced. HUD is responsible for administering programs intended to facilitate transactions that provide a significant public and private benefit, but that also place substantial HUD resources at risk. HUD is obliged to strike a balance between maximizing the facilitation of transactions and minimizing the risk to HUD resources, and considers the requirements of these documents, developed over a long period of deliberation that took into account extensive public comment, to strike an appropriate balance. HUD disagrees that the controls are not workable, but expects they will be applied in a reasonable manner that will neither discourage enterprise nor encourage imprudence.

Comment: A number of these actions, including incurring liabilities, paying out funds, incurring obligations to partners, only make sense if they apply to Project funds.

HUD response: The approvals noted by the comment apply in the context of activities in connection with the Project, as required by section 13.b. of the Regulatory Agreement.

Comment: With respect to transfers of property or interests , does HUD really intend to review and approve a corporate shareholder going from a 9 percent to a 10 percent stake, or a limited partner dropping from 25 percent to 23 percent under the definition of Principal and proposed section 23 of the Security Instrument (now designated section 21), which requires prior

written approval of HUD if the effect of a transfer of any interest in the borrower is the “creation or elimination of a Principal”?

HUD response: HUD approval of such transactions is a current practice that is continued under the revised documents.

Comment: Section 42(a) effectively prohibits the Borrower from hiring contractors to perform repairs or replacements without HUD’s prior written approval, since such contractors would have rights to file mechanic’s liens regardless of whether they actually “establish or maintain a lien.”

HUD response: To the extent that work performed by contractors constitutes Reasonable Operating Expenses, as redesignated section 37.c. has been revised to provide, HUD approval would not be required. Work that goes beyond Reasonable Operating Expenses would require HUD approval in any event.

Comment: Section 42(b) requires HUD’s consent to borrow funds or finance any purchase. If the sponsors wish to loan money to cover a project’s operating deficit, they cannot do so without getting HUD’s prior written approval. If a Borrower wants to charge incidental purchases to a credit card, HUD’s prior written approval, technically, would also be required.

HUD response: As similarly noted in a previous response, to the extent loans are used for current Reasonable Operating Expenses, prior written approval of HUD is not required.

Comment: Section 42(c), taken literally, prohibits a borrower from making payments of principal and interest on the note, payments for mortgage insurance premiums, or deposits into the replacement reserve (since these items are not reasonable operating expenses or necessary repairs) without HUD’s prior written approval except from Surplus Cash.

HUD response: Section 10 of the Regulatory Agreement requires Borrower to make

promptly all payments due under the Note and Security Instrument, and section 11 requires Borrower to establish and maintain a reserve for replacement account. HUD approval is not necessary for these explicit requirements with which Borrower must comply.

Comment: Section 42(d) requires approval for payment of any compensation to Principals or others with no exception for payments from Surplus Cash.

HUD response: In response to the comment, HUD has revised redesignated section 37.d. to exclude “permissible withdrawals” of Surplus Cash from the requirement for prior written HUD approval.

Comment: Approval under section 42(e) for any change of a management agreement is a dramatic change from current practice that only involves HUD if there is a change in the Management Certification.

HUD response: Because the management contract as a whole is subject to HUD approval, HUD approval is also required for any change to a management contract, to avoid piecemeal revisions of the original, approved terms of the contract. HUD Handbook 4381.5, The Management Agent Handbook, details the requirements for HUD approval of the Management Agreement, and therefore any changes to it.

Comment: Would HUD want to approve remodeling of a model unit or a leasing office, or the demolition or reconstruction of a carport or a storage shed, as would be required under section 42(g)?

HUD response: HUD agrees, in part, with the comment and redesignated section 37(g) will now permit Borrower to dispose of and replace Fixtures and Personalty and make minor alterations or changes that do not impair the security, without HUD’s prior written approval.

Comment: The prohibition on reconstruction without HUD approval is inconsistent with

the provision requiring restoration on an unconditional basis, even if HUD has failed to meet its obligations.

HUD response: The requirement for HUD approval for reconstruction in redesignated section 37(g) is not inconsistent with the requirement under redesignated section 20(c) to restore or repair any damage to the Mortgaged Property. To help clarify the intended distinction, section 37(g) has been revised to allow replacement and disposal of obsolete or deteriorated Fixtures or Personalty and minor repairs to be made without HUD approval. More substantial undertakings constituting “reconstruction” require HUD approval. In the event of uncertainty in a particular situation, approval may be requested, and HUD may determine if approval is required.

Comment: Section 42(g) must include some standard of materiality or be limited to expenditures over a certain threshold, e.g., \$100,000.

HUD response: As noted above, redesignated section 37(g) has been revised to allow replacement and disposal of obsolete or deteriorated Fixtures or Personalty and minor repairs to be made without HUD approval.

Comment: HUD does not have authority for the 42(i) requirement that a Borrower cannot receive any endowment that is not pledged to the Loan unless prohibited by the terms of the endowment.

HUD response: HUD has authority to establish the parameters of an eligible Borrower, and the requirement with respect to endowments is consistent with other requirements concerning the receipt of property to be used in connection with the Project.

Comment: HUD does not underwrite endowment funds (other than to meet closing requirements), should not have a security interest therein, and should not restrict a Borrower’s right to receive endowment funds.

HUD response: As noted above, HUD considers its requirements with respect to endowment funds to be consistent with HUD's regulation of Borrower use of property in connection with the Project.

Comment: The section 42(j) requirement that HUD approve virtually all amendments to the organizational documents of the Borrower is an unreasonable interference with the rights of the Borrower's owners and a dramatic change from current practice, which is limited to approvals of changes that affect HUD's requirements.

HUD response: HUD must have the right to approve in advance any changes in a Borrower's organizational documents that could affect the organization's ability to comply with its contractual and programmatic obligations or otherwise affect HUD's interests, so that HUD may exercise prudently its duty of oversight of the use of HUD resources. Redesignated section 37.j. now provides a nonexhaustive list of the types of amendments to the organizational documents that require HUD's prior approval.

Comment: Section 42(j) does not contain any standards for HUD to apply to consider requests for amendments to organizational documents.

HUD response: As noted previously, HUD will make its decisions based on the totality of the circumstances and proposed changes, and on a case-by case basis, while establishing an administrative record of its actions to demonstrate that HUD is not acting in an unreasonable or arbitrary manner.

Comment: The section 42(k) litigation threshold should be increased to at least \$50,000.

HUD response: HUD has reconsidered this litigation approval threshold in light of current litigation and settlement costs, and has increased the threshold in redesignated section 37(k) to \$100,000.

Comment: Section 42(k) would unnecessarily delay the process for the Owner and should be removed.

HUD response: While not removing the requirement for HUD approval of litigation, HUD has increased the threshold that triggers the approval requirement, as noted above.

Comment: Section 42(k) is a new requirement with no basis for the monetary cap. Is HUD seeking to convert all multifamily housing into a form of operated public housing?

HUD response: HUD has no such intent with respect to multifamily housing as stated in the comment. Because litigation may pose a substantial threat to the financial well-being of the Project, it is necessary for HUD to be apprised of significant activity in this area and to object to actions it determines to be inconsistent with that well-being. HUD considers the requirement to be reasonable in light of HUD's responsibilities.

Comment: What happens if the statute of limitations expires on a claim while HUD is considering a request under section 42(k)?

HUD response: If the statute of limitations is an issue with respect to any particular matter, HUD should be alerted about that issue as soon as possible, and HUD will expedite its response.

Comment: Requiring HUD to be a party to the settlement of litigation is not appropriate.

HUD response: It is not correct to refer to HUD as a party to the settlement of litigation. HUD's involvement is limited to assessing the effect of litigation on the Project.

Comment: Section 42(l), requiring approval of reimbursements for payment of expenses or costs of the Project, simply ignores the way projects are managed and operated.

HUD response: HUD has revised redesignated section 37(l) for clarity and to conform it more explicitly with other provisions of the Regulatory Agreement by adding the phrase, "except

for Reasonable Operating Expenses and in a manner consistent with Section 16.” Section 16 requires advances to be deposited into the Project account and permits reimbursement of advances without prior HUD approval. HUD expects that reimbursements for payments other than for Reasonable Operating Expenses will be an infrequent occurrence.

Comment: Section 42(m), taken literally, would prohibit a Borrower from receiving a refund of an overpayment or a payment on account of a warranty claim without HUD approval.

HUD response: HUD has revised redesignated section 37(m) to exclude warranty claims from providers of goods and services.

Section VII – Enforcement

Section 43 – Violations of Agreement

This section is now designated as section 38.

Comment: Violations related to felony criminal convictions or civil judgments is not understandable.

HUD response: The violation in redesignated section 38.c. is not any criminal conviction or civil judgment, but a civil or criminal forfeiture action. As stated in section 38.c., HUD’s concern is forfeiture or material impairment of HUD’s interest in the Mortgaged Property.

Section 44 – Declaration of Default

This section is now designated as section 39.

Comment: This section contains a new requirement that HUD can direct Borrowers to remove their partners. This is a clear violation of the Fifth Amendment and the Taking Clause of the Constitution.

HUD response: Consistent with the reduction of recourse liability on Key Principals

from the closing documents, HUD has removed from redesignated section 39 the language that appeared as section 44.g. and that required the removal of partners and other parties.

Section 46 – Nonrecourse Debt

This section is now designated as section 41.

Comment: Exception to Owner’s nonrecourse liability is unacceptable. Nonrecourse language here needs to be consistent with the nonrecourse provisions in the Note.

HUD response: Consistent with the decision not to impose broad recourse liability on Key Principals, HUD is revising the language that appeared in section 46. Redesignated section 41 now contains language consistent with the recourse provisions of section 17 of the existing Regulatory Agreement that is being replaced by the present document.

Section VIII – Miscellaneous

Section 42 – Compliance with Laws, originally section 28, has been moved from Section IV – Project Management to Section VIII – Miscellaneous in order to reflect HUD’s intention that Borrower comply with all laws at all times, not just in the context of “Project Management.”

Section 47 – Binding Effect

This section is now designated as section 43.

Comment: The reference to “such further time as HUD is ... obligated ... to protect the tenants of the Project” should be eliminated.

HUD response: HUD agrees that HUD’s obligations with respect to the tenants of the Project are independent of the Regulatory Agreement, and the reference noted in the comment is removed from redesignated section 43.

Section 51 – Present Assignment

This section is now designated as section 47.

Comment: This merely repeats the present assignment in the loan documents.

HUD response: Redesignated section 47 is necessary to perfect a security interest for HUD. The Regulatory Agreement is designed to be also a security agreement, as per section 53, now designated section 49.

Section 53 – Uniform Commercial Code Security Agreement

This section is now designated as section 49.

Comment: What is the reason for HUD to take a separate security interest in the UCC Collateral?

HUD response: HUD takes a separate security interest as a prudent measure to protect HUD's interest in the Mortgaged Property.

Comment: Will this security instrument be subordinate to the Lender's security interest?

HUD response: The UCC financing statement will indicate that HUD's security interest runs to HUD "as HUD's interest appears."

Comment: Will HUD file a form UCC-1?

HUD response: No, Lender is required under section 2 of the Security Instrument to perfect the security interest in the Mortgaged Property, and the Regulatory Agreement is incorporated in the Security Instrument.

Section IX – Section 8 Housing Assistance Payments Contract

Section 58 – Incorporation by Reference

This section is now designated as section 54.

Comment: It will not be easy to determine where there is a conflict between the Section 8 contract and the Regulatory Agreement, or where provisions are simply additional.

HUD response: This provision is a continuation of a provision under the existing

Regulatory Agreement. The intent is to provide a rule for resolution in the event that a conflict is present. A provision that is merely additional is not a conflicting provision. In any particular case, HUD will make the determination as to whether a conflict is actually present.

Signatures

Comment: HUD has never been clear as to who is an “authorized agent” and how a Borrower knows that a Regulatory Agreement is validly executed.

HUD response: HUD periodically publishes in the Federal Register Delegations of Authority that identify what authority is vested in which officials. The most current Delegations of Authority may also be found at HUD’s website.

Multifamily Note, form HUD-94001M

Comment: Footnotes should be added to the Note (e.g., in sections 3, 9), which allow for alterations to be made, provided they comply with HUD requirements, for matters traditionally left to negotiations between Borrower and Lender.

HUD response: HUD does not agree that such instructional footnotes would be appropriate because all changes negotiated by Borrower and Lender would have to be approved by HUD.

Comment: In the introductory section of the note, language should be added to recognize that construction loans can have a split rate – one for construction period and one for the permanent loan.

HUD response: This concept is set forth in the Note.

Comment: There should be a section dealing with construction loans that should include language to reflect standard practice of adjusting principal and interest payments after final endorsement to take into account the fact that the Loan has not been fully advanced. Such

language would provide for the payment of interest accrued on the outstanding principal balance plus scheduled principal amortization. There should be language that the Loan will be reamortized if there is a mortgage reduction at final endorsement.

HUD response: HUD does not view such a modification as a standard practice. Notes should be modified after approval in writing by HUD to reflect changes in the terms of the insured loan.

Comment: Language should be added to the Note to comply with the 5-year prepayment prohibition required by Section 223(f)(3) of the National Housing Act.

HUD response: It would be confusing to attempt to place restrictions for all programs in the Note. As has always been the case, the Note will need to be amended to accommodate unique program requirements that are not universal.

Section 3 – Payment of Principal and Interest

Comment: Section 3 of the Note should be split into “Alternative A – Permanent Loans” and “Alternative B – Construction Loans.”

HUD response: Such a change would be confusing because the Note is structured to cover insured advances during the construction phase and the permanent financing.

Section 7 – Late Charge

Comment: The previous uniform charge and grace period were widely accepted, but now have been made negotiable items. Negotiated fees usually mean higher charges for the Borrower, and are a fertile field for litigation.

HUD response: HUD agrees, in part, and has revised section 7 to provide that the Late Charge applies after 10 days. The revision is consistent with industry practice and facilitates compliance by Ginnie Mae issuers with their obligation to make payments to investors.

However, HUD is leaving the blank for the amount of the Late Charge to provide flexibility to the parties in negotiating amounts that reflect their preferences and market conditions.

Comment: The late charge provision in section 7 of the Note should be specified as 2 percent after 15 days, which is permitted by HUD.

HUD response: Although HUD believes that it is preferable to leave a blank for the amount of the Late Charge to permit flexibility, HUD agrees that number of days should be standardized. However, a period of 10 days, rather than 15, better reflects current industry practice, especially among Ginnie Mae issuers.

Section 8 – Limits on Personal Liability

Comment: Some exceptions are open to interpretation, i.e., why a failure to pay rents claimed by the Lender or the manner of applying insurance proceeds. Personal liability that could make the entire loan come due goes beyond some of the Transfer of Physical Assets requirements.

HUD response: Consistent with HUD's determination not to impose broad recourse liability on Key Principals, the references to Principals and to exceptions to personal liability in addition to those provided in section 8 are removed.

Comment: If the goal of nonrecourse carve-outs is to hold individuals personally liable for certain acts, HUD's current language essentially does that (see, e.g., section 17 of current Regulatory Agreement). Proposed section 8 goes well beyond current language by making a host of Principals liable for actions they did not take or authorize, and for events outside their control.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: The Key Principal Acknowledgement may require Ginnie Mae to adjust its mortgage-backed securities prospectus to the investor community. Any Ginnie Mae secondary mortgage market and investor ramifications must be fully explored.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: Section 8(b) – Minor violations of the Note should not result in recourse, e.g., a failure to timely deliver books and records, statements, schedules, or reports, especially if such failure is cured, or a small mechanic’s lien placed upon the Mortgaged Property.

HUD response: Borrower is liable only to the extent of any loss or damage suffered by Lender, which HUD considers to be a fair and reasonable provision.

Comment: Section 8(b) – Failure to pay rents and security deposits to Lender upon demand after default should not result in personal liability.

HUD response: As previously noted, liability is now limited to Borrower not to Principals, and continues to be limited to the extent of any loss or damage suffered by Lender.

Comment: Section 8(b) – The failure of the Borrower to apply proceeds as required by the Security Instrument should be conditioned to cover only proceeds actually received by the Borrower.

HUD response: Borrower’s liability is determined by its failure to make required payments, not by its failure to receive proceeds.

Comment: Most of the individuals in the overly broad definition of Principal do not control submission of books and records.

HUD response: As noted previously, HUD has removed Principals from section 8.

Comment: No measure of the liability is provided, suggesting open-ended liability.

HUD response: With the removal of broad recourse liability of Key Principals, liability of Borrower is now limited as provided in section 8: to the extent of the Mortgaged Property and any other collateral held by Lender; to the extent of loss or damage suffered by Lender; to the extent of repayment of all Indebtedness to Lender; and to the extent of indemnification required under redesignated section 48(k) of the Security Instrument-a provision added to section 8 to provide conformity in the documents.

Comment: Section 8(b) should recognize, as Fannie Mae and Freddie Mac do, that a Borrower may be unable to pay due to a valid court order in a bankruptcy, receivership or other judicial proceeding.

HUD response: The Contract of Mortgage Insurance and the Note between the Lender and Borrower require that the Note be paid by Borrower and does not provide for any extenuating circumstances, but HUD will act appropriately in the event of court proceedings.

Comment: Under section 8(b) a Principal's liability should be limited to the individual's own acts or acts the individual has authorized in violation of the applicable documents.

HUD response: As noted previously, HUD has removed Principals from section 8.

Comment: Section 8(c) – Many older partnership agreements flatly prohibit loans that are recourse.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: Section 8(c) creates “springing recourse,” since the recourse “springs” from the occurrence of a listed event. Each principal assumes the risk of repayment of the entire loan, should any of the events occur. This is more extreme than Fannie Mae, which limits liability for some events. Springing recourse should be eliminated.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: Section 8(c) – Does HUD really want to approve every acquisition of any sort of property, e.g., office supplies?

HUD response: The Security Agreement and Regulatory Agreement have been revised to address such issues. HUD approval is not required for payment of Reasonable Operating Expenses under the Regulatory Agreement.

Comment: Section 8(c) – Imposition of personal liability for liens, cross-citing section 18 of the Security Instrument, goes too far. The negative effect of the lien is already significant.

HUD response: Liability will be imposed on Borrower only when the granting of a lien or encumbrance results in an Event of Default under the Security Instrument.

Comment: Section 8(c) – It is far more serious and inappropriate to make an unauthorized transfer a basis of personal liability as opposed to an event of default. Under the revised Uniform Limited Partnership Act, parties can generally leave, retire, become bankrupt, and sell their assets without incurring personal liability.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: Section 8(c) – If a principal commits fraud, investors become twice victimized by suffering the fraud and then becoming personally liable for repayment of the entire indebtedness for the actions of another.

HUD response: As noted previously, HUD has removed the concept of broad recourse liability on Key Principals; therefore, the example of liability cited in the comment is no longer relevant.

Comment: The GSEs permit their borrowers to have unlimited transfers of limited partner interests. If HUD is seeking the enforcement remedies of the GSE transfer provisions, HUD should adopt the transfer rules and other approaches, such as a willingness to negotiate, taken by the GSEs.

HUD response: HUD is no longer seeking the enforcement remedies of GSE transfer provisions.

Comment: This section imposes liability on all principals, not just “Key Principals.”

HUD response: As noted previously, HUD has removed Principals from section 8.

Section 9 – Voluntary and Involuntary Prepayments

Comment: The references to prepayment premium under section 9 should be removed from the list of amounts that become due and payable under a Class A Event of Default.

HUD response: This suggested change was made to achieve uniformity.

Comment: The references to prepayment premium under section 9 should be removed from the list of amounts that become due and payable under a Class A Event of Default.

HUD response: This suggested change was made to achieve uniformity.

Comment: Section 9 of the Note should include two alternatives: “Alternative A – Base Form,” based upon the existing form Note and to be used in those circumstances where Alternative B is not available; and “Alternative B,” based on language from several lenders, available as permitted in section 12.1.4H of the MAP Guide.

HUD response: Section 9 has been revised to comport with current HUD policy in Program Obligations.

Comment: Section 9(1) allows a Borrower to prepay up to 15 percent each year without penalty. Section 3(b) provides no prepayment premium is due if prepayment is made within

some number of days before the maturity date. It is not clear if there is a lockout period at all, and HUD should clarify this issue.

HUD response: Lockouts are permitted in accordance with Program Obligations, and an alternative paragraph providing for a rider to address prepayment restrictions has been added to section 9.

Comment: Section 9, Prepayments, is incomplete in numerous respects. The use of a prepayment prohibition is not contemplated and there is no insert language for a prepayment premium per Mortgagee Letter 87-9, entitled, “Mortgage Prepayment Provisions for HUD-Insured and Coinsured Multifamily Projects,” issued February 10, 1987, which allows private participants to negotiate prepayment terms and language within bounds established by HUD.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: Section 9, while implying a prepayment lockout period and corresponding prepayment premium periods, does not clearly address these issues and could lead to litigation over its intent. There should be a clear statement that the note may not be prepaid in whole or in part, except as provided.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: The last sentence in section 9(a)(1) [“No default shall exist by reason of nonpayment of any required installment of principal so long as the amount of optional additional prepayments of principal already made pursuant to the privilege of prepayment set forth in this Note equals or exceeds the amount of such required installment of principal.”] is inconsistent with Ginnie Mae programs and bond rating requirements and should be removed, or a footnote

added authorizing deletion whenever the loan is funded with Ginnie Mae securities, bonds, or other methods that are inconsistent with this sentence.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues. The rider would override any provision such as that noted in the comment.

Comment: Section 9(a)(2) requiring Borrower to pay the prepayment premium even if the loan is accelerated makes good business sense and protects the investor community.

HUD response: The provision that was previously found in section 9(a)(2) has been removed to accommodate the flexibility provided by the addition of an alternative paragraph in section 9(a)(1). Previous section 9(a)(3) has been redesignated section 9(a)(2).

Comment: The reference in section 9(a)(2)(ii) to the prepayment calculated pursuant to 9(a)(1) is incorrect, since no prepayment premium is calculated in 9(a)(1).

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: Section 9(b) provision mandating no prepayment premium prior to the Maturity Date is contrary to Mortgagee Letter 87-9, unless HUD is changing its policy to allow longer prepayment restrictions.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: There should be an express prohibition on prepayments other than as expressly permitted.

HUD response: There is not currently an express prohibition against prepayment, and HUD does not consider such a prohibition to be necessary.

Comment: Prepayments without penalty should be permitted when required by HUD due to a cost certification or similar report or if amortization is advanced under applicable HUD regulations.

HUD response: A reduction in the amount of the mortgage as a result of cost certification should occur prior to the commencement of amortization and, therefore, should not be applicable. In other circumstances, the requirements of 24 CFR 200.87(b) would govern the terms of the prepayment.

Comment: The right of HUD to override a prepayment penalty or lockout is missing.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: Can a Lender impose a prepayment premium and, if so, how high, if the Loan is accelerated during the lockout period.

HUD response: The concerns of the comment have been addressed by the addition of an alternative paragraph in section 9 to address such issues.

Comment: Is HUD's permission required to prepay the loan?

HUD response: The loan is designed not to require HUD approval. A rider may be added where HUD approval would be appropriate.

Section 10 – Costs and Expenses

Comment: The Borrower should not be required to pay all costs and attorney's fees if there is any default. Fees and costs should be determined by a court having jurisdiction.

HUD response: This provision provides an incentive for Lender to pursue collection and to enforce the provisions of the Loan Documents. When HUD acts in a nonjudicial foreclosure, there is no court to determine costs.

Section 13 – Loan Charges

Comment: This section is not necessary since the Lender should be able to determine if the loan is usurious, and the Lender and HUD require an opinion from Borrower’s counsel to that effect. In rare instances where charges are usurious, the Lender should bear the consequences, and the Borrower should have the right to recover costs and expenses in enforcing penalties.

HUD response: HUD disagrees with the comment. This section clarifies the rights and responsibilities of Borrower and Lender in this situation, and how the “excess” is to be applied. Application of the excess to reduce the unpaid principal balance best serves the public interest by reducing HUD’s exposure to risk.

Section 16 – Governing Law

Comment: The language in the Note conferring exclusive jurisdiction on the state or federal courts located in the Property Jurisdiction should be removed. There may be circumstances where it may be necessary to bring an action against the borrower in a court outside the Property Jurisdiction; for example, if a Borrower files bankruptcy in a jurisdiction outside the Property Jurisdiction.

HUD response: Section 16 provides: “This Note shall be governed by the law of the Property Jurisdiction, except as such local law may be preempted by federal law.” This language is adequate to cover the concern iterated in the comment. If, for example, Borrower files for bankruptcy outside the Property Jurisdiction, a filing in a federal court would be governed by federal law, and a filing in a state court would be governed by the law of the property jurisdiction as to matters that arise under the Note.

Section 20 – Waiver of Jury Trial

Comment: Why should HUD, a federal agency, follow the lead of commercial banks that insist on these unfair provisions to Borrowers by denying them the fundamental right of a jury trial? This provision should be eliminated.

HUD response: HUD has made a conscious effort to adopt current commercial practices in revising the closing documents, and this is a current commercial practice.

Acknowledgement and Agreement by Key Principal

Comment: There has been litigation, which HUD is inviting here, over the form and validity of guaranties, whether or not there is consideration for the guaranty.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Comment: The liability of the guarantor should be limited to monies withdrawn from the project in violation of the Regulatory Agreement.

HUD response: As noted previously, HUD has determined not to impose broad recourse liability on Key Principals.

Social Security and Tax Identification Numbers for Signatories

Comment: Unlike Fannie Mae and Freddie Mac, HUD is subject to the Freedom of Information Act, and requiring Social Security and tax identification numbers for signatories may result in the dissemination of highly sensitive personal material.

HUD response: Although HUD considers the information identified by the comment to be exempt from disclosure under exemption 6 of the Freedom of Information Act, HUD is removing the requirement that this information be provided by the signatory.

Agreement and Certification, form HUD-93305M

Section 4

Comment: In section 4, the list of Principals should include “managers” and “members.”

HUD response: HUD agrees with this comment and has added this language.

Section 14 – Bar against Undisclosed Side Agreements

Comment: The current permissibility of certain undisclosed side agreements with contractors is abolished. Such agreements provide necessary flexibility and additional funding where required and are a sound business practice that should not be abandoned. The ability of project principals to have their rights and obligations recorded in side agreements should not be disallowed or delayed by an unnecessary HUD review and/or approval process. HUD’s interests will be adequately protected by a certification that there are no side agreements, except “Permitted Side Agreements,” defined as agreements relating to construction of the project that meet certain requirements, including that the borrower shall not be a party thereto or have obligations there under, and that HUD’s requirements prevail in the event of a conflict.

HUD response: HUD has removed this section completely from this document. These disclosures are now covered in section 8 of the Regulatory Agreement.

Comment: In section 14, the Construction Contract does not include costs of offsite work and certain types of demolition work. This is work typically performed on the Project or related property.

Section 14 also should provide for “Permitted Side Agreements” defined as “an agreement which relates to the construction of the Project and which meets each of the following requirements:

- (i) The Borrower shall not be a party thereto or have any obligation there under; and
- (ii) The Permitted Side Agreement shall include the substance of the following

provisions:

In the event of any conflict between this Section and any other provisions of the Agreement, the provisions of this Section shall be controlling. In the event of any conflict between any provision and this Agreement and any applicable HUD rule, regulation or requirement, such HUD rule, regulation or requirement shall be controlling. [the Borrower] shall have no obligations under this Agreement. Contractor agrees that it will not assert any claim under this Agreement against [the Borrower], the Project, proceeds of the HUD-insured loan on the Project and/or the interests of [third-Party Obligor] in the Project for any obligations of [Third-Party Obligor] under this Agreement. The obligations of Contractor under the Construction Contract between [the Borrower] and Contractor are and shall be separate and independent of the rights and obligations of [Third-Party Obligor] and Contractor under this Agreement. Without limiting the generality of the foregoing, Contractor shall fully perform its obligations under the Construction Contract in accordance with its terms regardless of whether or not [Third-Party Obligor] has performed its obligations under this Agreement.”

Finally, with respect to section 14, the suggestion was made that HUD not prohibit or review “side agreements,” which most often address the amount and means of payment of the General Contractor’s profit. Side agreements may also address other issues such as: the profit on change orders; penalties or rewards for meeting a staged completion schedule; the time frame for delivery of the General Contractor’s cost certification; cooperation in release of the retainage consistent with HUD requirements; requiring the General Contractor to fund HUD-required escrows for incomplete construction items; payment of interest on the retainage to the General Contractor for some or all of the period between construction completion and final endorsement; and requiring the General Contractor to comply with the 50 to 75 percent Rule.

HUD response: HUD has removed this clause completely from this document. These disclosures are now covered in section 8 of the Regulatory Agreement.

Escrow Agreement for Noncritical Deferred Repairs, form HUD-92476.1M

Responsibility for approval not clear

Comment: The proposed document removes HUD’s signature, removes any reference to HUD’s approval rights, and makes no reference to the revised Request for Approval of Advance

of Escrow Funds, which continues to provide for HUD approval for withdrawals. If the Lender alone is authorized to approve funds withdrawals, the form should provide for a reasonable fee. If HUD intends to retain withdrawal approval authority, the document must be revised.

HUD response: HUD has amended the document to clarify HUD's approval authority over the release of funds from the escrow portion of the loan proceeds.

Escrow Agreement for Working Capital, form HUD-92412M

Comment: The language in the third introductory section should be removed, which states that the working capital deposit has not been included in the Mortgage Loan proceeds, and that the deposit could be funded from excess cash available to the Borrower, and that the requirement applies to both for-profit and nonprofit Borrowers.

HUD response: Although HUD has revised the term "mortgage loan proceeds" to "Loan proceeds," HUD disagrees with the commenter that this provision should be removed.

Section 1

Comment: Since this agreement may be executed and dated before the date of initial endorsement, section 1 should be revised to reflect that the deposit shall be made at or before initial endorsement.

HUD response: HUD believes that the language as currently contained in the agreement is appropriate. If the deposit is made before initial endorsement, the deposit is therefore available at endorsement.

Comment: Since the Lender may sign the Agreement and the Agreement may be dated before initial endorsement, the Lender should not be expected to acknowledge receipt of the deposit.

HUD response: The Agreement contemplates that the Lender will not sign unless the

Borrower has made the deposit.

Comment: The Deposit should be permitted to be partially in the form of cash and partially in one or more letters of credit, rather than cash or a letter of credit.

HUD response: HUD agrees with this suggestion. In section 1, HUD has added “and/or” after the checkbox for “cash” to show HUD’s new policy of allowing a mixture of cash and a letter of credit.

Section 3 – Interest to Borrower

Comment: Although the creation of the Escrow Agreement is applauded, section 3 requires return to Borrower of any balance of funds, together with interest earned. Continuation of current HUD policy is urged: the Replacement Reserve Account is only an escrow account subject to interest payment to Borrower and only if the Borrower specifically requests such payment.

HUD response: HUD agrees with the comment to continue current HUD policy, and the reference to interest has been removed.

Comment: In section 3, under current HUD requirements, the working capital escrow is released one year after the construction completion date if the mortgage is not in default, and this date should be maintained. The new form provides for release after the date of sustaining occupancy. This change brings HUD into the administration of an escrow that has always been Lender’s responsibility. The change will likely result in the earlier release of the deposit, since most projects exceed sustaining occupancy in less than one year after construction completion and those that have not achieved this by that time have often exhausted their working capital escrows well before the end of the one-year period.

HUD response: HUD agrees with the commenter and has revised the language of

section 3 to provide that any funds remaining in the deposit the later of: (a) one year after construction, or (b) after the date of sustaining occupancy as determined by HUD, will be returned to the Borrower.

Comment: In section 3, adding “interest earned on funds” is not appropriate because HUD is not relying on interest earnings in its underwriting and no interest earnings would exist if letters of credit are used. References to interest should also be dropped from sections 5 and 6.

HUD response: HUD agrees with this comment and has removed references to interest earned in sections 3 and 6, which deal with the disbursement of the Deposit. The reference in section 5, which provides how the Deposit is held, is retained.

Section 4

Comment: In section 4, it is unclear how a borrower “certifies at firm commitment” that it will apply the balance in the escrow in a certain way. This is a firm commitment condition imposed by HUD following subsidy layering review.

HUD response: HUD disagrees with this comment. The borrower in fact certifies at firm commitment that it will apply any balance of funds to the reserve for replacement or other restricted account specified by HUD.

Section 5

Comment: In section 5, language that allows Lender to draw upon a letter of credit at any time and convert it to cash should be added to make it more difficult for a borrower to interfere with a draw upon a letter of credit, and to make the section more consistent with HUD’s requirement that such letters of credit be unconditional and irrevocable.

HUD response: HUD agrees with this comment and has added language that provides that the Lender may, for purposes of the Escrow Agreement for Working Capital, draw upon any

letter of credit included in the Deposit and convert the same to cash.

Building Loan Agreement, form HUD-92441M

Section 4 — Advances

Comment: Under section 4(a), advances should include the value of materials and equipment purchased but stored off-site.

HUD response: HUD agrees with the commenter and has revised the language in section 4(a) to include the value of materials and equipment purchased but stored off-site.

Comment: HUD should add to section 4(c), “In any event, disbursement of mortgage proceeds in an amount sufficient to satisfy a GNMA requirement for good delivery of mortgage-backed securities at initial endorsement is permissible.”

HUD response: HUD has revised section 4(c), but has not incorporated the language requested by the commenter.

Section 5 – “Soft” Costs Disbursed by Lender to Borrower

Comment: The line items listed in section 5 should not be interpreted as limiting, with no allowance for adding such typical items as architectural fees for design and supervisory services, contingency in a rehabilitation project, and Mortgagor’s “other fees.” Section 5 should be tailored to the deal at hand.

HUD response: HUD agrees with the comment and has revised section 5 to remove the list of items eligible for payment and has substituted a reference to an Exhibit B, in which the parties will itemize applicable charges or items.

Section 7 — Insured Advances

Comment: Rather than an extension of the title policy for each insured advance, the alternative of current mechanic lien reports should suffice in a state where the insured loan has

continued priority over liens.

HUD response: HUD disagrees with this comment. The alternative of a mechanic's lien report is a lesser standard. The extension of the title policy best protects HUD's interest.

Section 14 – Wages

Comment: The end of section 14(b)(ii) should be revised to read, “...which may be published as of the date the firm commitment was first issued.”

HUD response: The language in section 14(b)(ii) is consistent with the Department of Labor regulations at 29 CFR 1.6(a)(3)(N).

Section 19 – Liability for Advances

Comment: Personal liability is an extreme remedy when there could be numerous instances where the agreement is violated involuntarily or unintentionally by the Borrower; for example, by the owner's contractor or if the insured advance is paid out in a way that violates Davis-Bacon requirements. Personal liability should be limited to knowing and deliberate violations. Another comment suggested that such violations should only be events of default not resulting in personal liability of the Borrower.

HUD response: HUD agrees and has removed section 19 concerning personal liability.

Section 20 – HUD not a Party

Comment: This section should state that HUD has an obligation to perform all of its duties in a timely manner.

HUD response: HUD declined to adopt this comment. HUD is not a party to the Building Loan Agreement.

Guide for Opinion of Borrower's Counsel, form HUD-91725M

Preamble

Comment: The phrase, “The Borrower has requested that we deliver this opinion and has consented to reliance by Lender’s counsel in rendering its opinion to Lender...” should be changed to, “The Borrower has requested that we deliver this opinion and has consented to reliance by Lender’s counsel in its representation of Lender... .” Lender’s counsel does not typically render an opinion to the Lender in connection with the Loan transaction.

HUD response: HUD agrees in part with this comment and has revised the Preamble accordingly.

American Bar Association (ABA) Guidelines

Comment: HUD fails to acknowledge the ABA Guidelines for Preparation of Closing Opinions.

HUD response: HUD disagrees with this statement. To the extent that HUD departs from the ABA Guidelines, it is because HUD needs the information to manage prudently the risk to public resources being made available. The Opinion is the most appropriate source for the information HUD needs.

Increased Cost

Comment: Changes will substantially increase the cost of an opinion letter and reduce the number of competent attorneys willing to provide it.

HUD response: The substantive changes made to the Guide from the one in use were minimal and were responsive to suggested changes. The changes were largely directed to clarifying changes and some updates in terminology where appropriate and have not imposed any stricter standards inconsistent with what had been done previously. Some sections concerning actions or knowledge of the Lender have been moved to the Lender’s Certificate.

These types of changes will not result in a substantial increase in cost or reduce the number of competent attorneys willing to provide the opinion.

Not an Opinion

Comment: One commenter stated that the Certification/Warning is inconsistent with the nature of an opinion — an opinion certified to be true is not an opinion but a guarantee. Two other commenters stated that requiring an Opinion and a Certification/Warning is redundant, overkill, and insulting.

HUD response: HUD agrees in part with these comments. The language of the Certification/Warning has been revised to provide: “This instrument has been made, presented, and delivered for the purpose of influencing an official action of HUD in insuring the Loan, and may be relied upon by HUD.” Additionally, the heading “Certification/Warning” has been removed.

Comment: The Guidelines require counsel to opine as to the future acts and behavior of individuals or entities a lawyer does not and may never represent. Such an opinion would not be covered by malpractice insurance.

HUD response: HUD has revised the Guidelines to ensure the scope of counsel’s opinion is appropriate to the transaction and to the individuals or entities that counsel represents.

Deviations

Comment: The certification regarding unapproved deviations from the form opinion letter would require a corresponding certification from HUD counsel as to the approved deviations.

HUD response: HUD disagrees that a corresponding certification is needed. The purpose of the certification regarding unapproved deviations from the form opinion letter is to

identify and disclose changes. HUD's continuation with the closing, in light of the changes made to the opinion letter and disclosed to HUD, constitutes HUD's approval.

Scope of Opinion Letter

Comment: While Fannie Mae and Freddie Mac have reduced the scope of their opinion letters, HUD is going in the opposite direction, which may place HUD at a competitive disadvantage.

HUD response: The scope of HUD's opinion letter is not the same as the scope of Fannie Mae's and Freddie Mac's opinion letters, because the scope of the transactions carried out by HUD, Fannie Mae, and Freddie Mac are not the same. HUD provides mortgage insurance on construction advances, and neither Fannie Mae nor Freddie Mac provides construction advances. The scope of HUD's opinion letter protects the scope of HUD's interests in the transaction.

Comment: It is impracticable to demand that Borrower's Counsel personally explain the Regulatory Agreement to each Principal.

HUD response: HUD agrees and has removed that language, which appeared as paragraph (g) under the heading, "We [I] confirm that:" in the Opinion.

Reliance Language

Comment: Reliance language should state that the subsequent note holder may only rely on the Opinion to the same extent as, not greater than, the addressee.

HUD response: HUD disagrees with this recommendation. The reliance language is consistent with modern opinion practice.

Comment: It is presumptuous of HUD to disregard case law and to continue to demand that Borrower's Counsel's Opinion be addressed to and relied upon by both HUD and Lender.

HUD response: HUD disagrees with this view. HUD has a significant interest in the loan, and therefore HUD must be able, same as the Lender, to rely upon Borrower's Counsel's Opinion.

Financial Interest in Project

Comment: Certification of no financial interest needs to be reevaluated in light of structures of today's transactions. A lawyer's holdings in mutual funds, real estate investment trusts (REITS), and public companies could all be technically indirect and impermissible holdings.

HUD response: In order to protect HUD's interest, the attorney must confirm that he or she has no financial interest, direct or indirect, in the Project, the Property, or the Loan, other than as specified in paragraph (c) of the opinion Guide. However, in recognition of the concerns expressed in the comment, HUD has revised the language in paragraph (d) of the opinion Guide regarding undisclosed interests, to state that the attorney has no interest in the subject matters of the opinion other than as previously disclosed and approved by HUD, and has added the phrase "Except as provided in paragraph (d)" to paragraph (c).

HUD Resources

Comment: HUD's failure to have adequate staff should not be a reason for failure to negotiate an opinion acceptable to different law firms and their liability insurers.

HUD response: The opinion represents HUD's current practice and is not related to any resource or staffing issues. It is HUD's intent to establish and maintain a uniform set of documents for multifamily property transactions to provide stability and predictability for such transactions, and to minimize, as much as possible, negotiations and the potential for inconsistencies and unanticipated consequences.

Identity of Interest

Comment: Identity of interest between Lender and Borrower, if disclosed, should be permitted in projects not covered by the MAP Guide.

HUD response: HUD agrees and has removed the limiting language, which appeared as paragraph (e).

Joint Opinion

Comment: The opinion should affirmatively take into consideration that transactional counsel for Borrower may choose to rely on local or specialty counsel with respect to certain issues within the opinion.

HUD response: HUD agrees with this suggestion, and the Opinion includes language to designate either general or special counsel for matters that may require a separate opinion by specialty counsel.

Signatory

Comment: It is the practice to have a signature of the law firm on an Opinion, rather than the name and signature of a particular attorney at the firm.

HUD response: It is also still the practice, however, to have the signature of an attorney authorized to sign on behalf of the law firm. HUD prefers this practice and, therefore, has not changed the document as suggested by the commenters.

Liens, Encumbrances

Comment: Most institutional Lenders do not release their liens until they have been paid. In requiring that there “cannot be any liens and encumbrances on the Mortgaged Property when HUD endorses the Note for insurance,” HUD has created a “Catch-22” that no other Lender in the country insists upon when making a new secured loan that pays off an existing

secured loan. The normal practice is to process releases after closing.

HUD response: The requirement of a first lien reflects the requirement of the National Housing Act. The National Housing Act requires that HUD insure a first lien.

Section M

Comment: The correct name of the escrow (Escrow Agreement for Working Capital) should be used in section M, and Lender should be included in addition to Borrower as a signatory.

HUD response: HUD agrees with the comment, and the revision has been made to section M.

Section N

Comment: The section should include form 92412M and signatory parties (Borrower, Lender, the General Contractor, and HUD) to the Agreement and Certification.

HUD response: HUD agrees in part and has revised section N to include an instruction to insert the appropriate parties.

Section Q

Comment: The defined term “Filing Offices” should be used in place of general language (“county and Property Jurisdiction [and Organizational Jurisdiction].”)

HUD response: HUD agrees in part with the comment and has revised section Q to require the insertion of the appropriate UCC filing office(s).

Section T – Evidence of Zoning Compliance

Comment: HUD must recognize that some jurisdictions no longer issue Zoning Letters.

HUD response: HUD does recognize this, and the Guide and Opinion account for such local law variations.

Section W— Survey

Comment: The phrase “showing completed project” should be eliminated or followed by “if any.”

HUD response: The “or” in the language of section W makes the inclusion of “if any” unnecessary.

New Article 9

Comment: The new Article 9 has revised the rules as to perfection of security interests in personalty owned by debtors that are registered entities. Instead of filing in the jurisdictions where the personalty is physically located and where the debtor’s chief executive office is located, perfection is achieved by filing with the Secretary of State in the jurisdiction where the debtor is formed. This section should be required only for debtors that are individuals and unregistered entities, such as general partnerships.

HUD response: As a result of comments pertaining to the UCC, HUD has reviewed all provisions in all documents and has made revisions as necessary.

Section 4

Comment: The first sentence is unqualified and too broad, and the second sentence is rendered redundant by the first. A single sentence should state that the Borrower has obtained all necessary approvals for the execution of the loan documents and the ownership and operation of the property.

HUD response: Section 4 has been removed because HUD agrees that certain representations in the section should be made by Lender. The Lender’s Certificate has been expanded to include them.

Section 5 – Loan Documents Subject to Qualifications

This section is now designated section 4.

Comment: It is unreasonable to require an opinion as to the enforceability of an unenforceable provision.

HUD response: HUD agrees that would be unreasonable, but the document does not require enforceability of an unenforceable provision.

Section 7 – Loans Involving Construction or Rehabilitation

This section is now designated section 6.

Comment: It is unreasonable to require an opinion as to “proposed” changes of law or ordinance.

HUD response: The language with respect to proposed changes in (now designated) section 6 is qualified by the phrase “to our knowledge.”

Section 13

This section is now designated section 11.

Comment: This section should be revised consistent with section G regarding revised Article 9.

HUD response: HUD agrees with this comment and has revised section 11, for example, by adding “as its interests appear” following the reference to HUD.

Instructions to Opinion, form HUD-91725M

Section OO - Docket Search

Comment: The statement that a docket search in the jurisdiction where the Borrower is located is not necessary if a sole-asset Borrower is being created should be clarified to indicate the time frame in which the sole-asset Borrower is created, i.e., not more than 90 days preceding initial endorsement.

HUD response: HUD agrees and this clarification has been made for the docket search provision, which is now section NN.

Comment: Does the requirement for a docket search of a general partner of a mortgagor mean that a search of a managing member of a limited liability company mortgagor is not required?

HUD response: The language has been revised to clarify that the search is limited to the location of the project, unless the Borrower is created or located in a jurisdiction other than the project, in which case record searches in both jurisdictions will be necessary. HUD believes this revised language addresses the commenter's concern.

Certification of Borrower, form HUD-91725M (Exhibit A)

Section 3 Location of Secured Property

Comment: This section should be updated to comply with revised Article 9.

HUD response: HUD agrees and has updated accordingly.

Section 7 – Source of Funds

Comment: The first sentence should be clarified to read, “The source(s) of any funds advanced by Borrower for purposes of meeting any equity requirement, including second debt, of HUD or contributing to the”

HUD response: This section was removed completely from the Certification of the Borrower. Source of funds is now addressed in the Lender's Certification.

Construction Contract, form HUD-92422M

Contractor's Progress Schedule

Comment: It would make sense to require integration of a Contractor's Progress Schedule into the Construction Contract with conditions for reasonable extensions to prevent

amending the Schedule without HUD consent.

HUD response: HUD disagrees with this recommendation. The Contractor's Progress Schedule is used as an underwriting tool and therefore not appropriate to insert into a legally binding document.

Article 2 – Identification of Contract Documents

Comment: In section A(2) of Article 2, excepting the mandatory arbitration provisions contained in AIA A201-1997, General Conditions, would be to exclude standard industry practice for resolving numerous construction complaints, issues, and disputes.

HUD response: HUD disagrees. This provision assists in maintaining the appropriate level of flexibility, and it is necessary to protect HUD's interest.

Comment: In section A(2) of Article 2, the present contract references only the current form of General Conditions; is there a reason for requiring the 1997 edition?

HUD response: The 1997 edition represents the latest revision that HUD has approved.

Comment: The list of Contract documents should include, "All Change Orders (as defined in section D below)."

HUD response: HUD agrees in part with the comment and has revised the list to include the following language: "Any change orders approved by HUD after the execution of this Contract."

Article 3 – Time

Comment: The requirement that completion of all punch list items and the otherwise open nature of the prerequisites for execution of the final Trip Report is potentially counterintuitive and could cause delay.

HUD response: HUD disagrees. The requirement is not a new requirement, and HUD

has no information to indicate that the execution of the final Trip Report is potentially counterintuitive and could cause delay.

Article 7 – Obligations of Contractor

Comment: In section C of Article 7, the introductory language should read: “Upon completion of construction, the Contractor shall furnish at the Contractor’s expense a survey map meeting HUD requirements... .”

HUD response: HUD disagrees and did not revise the introductory language as suggested by the commenter. However, HUD has revised this provision to include the following language: “To the extent such data shows that the Contractor has deviated from the Plans and Specifications, Contractor shall be responsible, at its own expense, for correcting such deviations.”

Comment: In section 7C, rather than attempt to enumerate all survey requirements in the Construction Contract, it would be much more economical from a drafting standpoint simply to require the Contractor to produce an as-built survey and Surveyor’s Report in accordance with HUD requirements and otherwise acceptable to Lender and HUD.

HUD response: HUD does not generally agree with the comment but has amended section 7C to indicate that the survey has to be prepared in accordance with ALTA-ACSM standards.

Article 9 – Waiver of Lien or Claim

Comment: With respect to section A of Article 9, requiring lien waivers from subcontractors should be eliminated. It would be impossible in some states (e.g., California) to obtain such waivers from subcontractors or suppliers.

HUD response: HUD prefers to address this issue on a case-by-case basis. This

provision is important and HUD, therefore, is not removing it completely from this contract.

Comment: In section B of Article 9, the second sentence should also be prefaced by “In jurisdictions where permitted by law...”

HUD response: HUD does not consider the recommended change to be necessary.

Comment: Article 9 should state that a contractor lien will likely result in termination of further advances under the Building Agreement.

HUD response: The contractor is not a party to the Building Agreement, and the recommendation is not adopted.

Signature Page

Comment: Rather than specifying “six (6) counterparts,” the signature line should refer to “multiple” counterparts.

HUD response: HUD considered the issue raised by the comment and determined that at least six counterparts are required in all cases. Therefore, “at least” language has been added to cover any contingency where more will be required.

Lease Addendum, form HUD-92070M

Section (b) (HUD acquires title)

Comment: This provision giving HUD an option to purchase fee simple title to a leasehold estate where HUD acquires title to the leasehold estate will not be acceptable to a Ground Lessor and will eliminate HUD-insured loans secured by a ground leasehold. The reference back to section (b) in section (e)(1) should also be removed.

HUD response: The option is not new, but represents a longstanding HUD policy.

Section (f) (Lease termination)

Comment: Sixty days for notice of monetary default from Lender to a Tenant is too long

and will be unacceptable to most landlords.

HUD response: HUD disagrees. HUD believes that 60 days presents a reasonable time frame.

Comment: The 180-day cure period is too long and a commercially unreasonable requirement to impose upon a Ground Lessor.

HUD response: HUD disagrees. HUD believes that 180 days presents a reasonable time frame.

Comment: Where a Ground Lessor gives HUD or a Lender additional rights, it will want to be paid all monetary obligations to be kept whole, and will want to be assured that HUD or the Lender pays property taxes, insurance, and other obligations of the tenant.

HUD response: If there is a default on the Mortgage, Lender is obligated to pay costs such as taxes and insurance to preserve the property.

Section (g) (Possession of property)

Comment: A Landlord will never agree, after termination of the Ground Lease and retaking possession of the Property, to give Landlord or HUD an additional 6 months to enter into a new Lease with the Landlord.

HUD response: HUD considers this a reasonable time to enter into a new Lease. This period is also the maximum allowed, and is not expected to be the norm.

Section (h) (Landlord joining Tenant in applications)

Comment: This section should allow modifications in the event the Landlord is a public agency, as HUD has previously permitted, for example, providing the public agency/Landlord 30 days to join the tenant, and adding a qualification “to the extent that it may within the exercise of its municipal powers and responsibilities.” Further a public agency cannot irrevocably appoint

the Tenant as its attorney-in-fact to execute papers.

HUD response: HUD has added the suggested qualification to this paragraph.

Request for Endorsement of Credit Instrument, form HUD-92455M

Comment: The Lender should be required to submit a Security Agreement only for Personalty that state licensing officials mandate to be maintained at a Facility for licensing purposes.

HUD response: The Lender is required to submit a Security Agreement for Personalty necessary for operation of the project. This requirement, which appeared in an unnumbered paragraph, is now included in a paragraph designated as section 2.

Section 2 - Impounds

This section is now designated as section 8.

Comment: A statement should be added that impound accounts for taxes and insurance (excluding mortgage insurance premiums) if collected by a first mortgagee may be deferred until the first mortgage is paid in full.

HUD response: HUD disagrees with the suggestion. These requirements apply only to the first mortgage.

Section 8 – Reserve Fund for Replacements

Comment: A statement should be added that reserves for replacement should be allowed to remain with the first mortgagee until payment in full of the first mortgage. Thereafter, the second mortgagee would begin collecting replacement reserves.

HUD response: HUD disagrees with the suggestion. This requirement applies only to the first mortgage. However, this provision has been removed from the Request for Endorsement form.

Section 19 – Approval of transfer of project

This section is now designated as section 13.

Comment: Rather than limit the Lender’s fee for reviewing a transfer to actual expenses incurred, Borrower should reimburse Lender for reasonable, actual, and necessary expenses.

HUD response: HUD disagrees, and has not adopted this recommendation.

Comment: Section 19 is part of a document that is probably not binding on successor mortgagees; its provisions should be made part of the Deed of Trust.

HUD response: The requirement has been removed from the Request for Endorsement form and is included in the Lender’s Certification, which has been clarified to apply to successors and assigns.

Residual Receipts Note (Limited Dividend Mortgagors), form HUD-91712M

Section 3 - Prepayments

Comment: This section prohibits prepayment of interest prior to maturity of the note. Why is prepayment of principal permitted, but not prepayment of interest?

HUD response: Prepayment of principal is permitted only from residual receipts and only upon obtaining prior written approval from HUD. This is longstanding HUD policy, and HUD considers it an appropriate limitation for Limited Dividend Mortgagors. If a Limited Dividend Mortgagor were permitted to take interest, which generally would occur after several years when interest would be compounded, this would make it possible for the mortgagor to exhaust the funds that would otherwise be available to the Project and could have the effect of increasing distributions if interest prepayment were permitted.

Surplus Cash Note, form HUD-92223M

General

Comment: HUD should allow payments to be made semi-annually since surplus cash may be distributed semi-annually.

HUD response: HUD agrees and has clarified the undesignated introductory paragraph to provide that payment may be made semi-annually.

Comment: A section should be added to allow for principal payments from surplus cash.

HUD response: HUD does not restrict the owner's discretion on the use of surplus cash. The owner retains the discretion to use surplus cash.

Comment: A section should be added that allows for other provisions that are not inconsistent to be added to the document.

HUD response: HUD does seek consistency in the use of its form documents, and does not consider open-ended documents to be appropriate. However, where necessary, other provisions would be included, consistent with section 29 of the Lender's Certificate, which addresses changes in the closing forms.

Section 2 – Payment from Surplus Cash

Comment: It is unreasonable for the Maker/Owner to be in default for not making payments even in instances when surplus cash is not available.

HUD response: HUD disagrees. Payments would not be made if surplus cash were not available.

Comment: The language “to the extent of available Surplus Cash” should be added to the end of section 2, as follows: the restriction on payment imposed by this section shall not excuse any default caused by the failure of the maker to pay the indebtedness evidenced by the Note to the extent of available Surplus Cash.”

HUD response: As HUD noted in a response to an earlier comment, HUD does not restrict the owner’s discretion on the use of surplus cash. The owner retains the discretion to use surplus cash prudently.

Section 4 – Prepayment

Comment: This section allows Maker to pay principal on Note “on any interest payment date,” but the Note provides that interest is payable annually, so that principal can only be paid once a year. The first sentence should be revised to read, “Maker may pay any part or all of the principal and interest on this note without penalty at any time.

HUD response: HUD has not adopted the change recommended by the commenter.

Section 5 – Payment from other than project assets

Comment: This is inconsistent with section 2, which limits payments to surplus cash. In addition, section 5 is inconsistent with the new Regulatory Agreement.

HUD response: There is no inconsistency with section 2 or the Regulatory Agreement because section 5 pertains to payments from sources other than Project Assets.

Section 7

Comment: Section 7 should also be cited as “Notwithstanding” in section 5. Section 7 should be modified so that prepayments from non-Project sources (often tax credit syndication proceeds) are permitted prior to final closing.

HUD response: The modifications requested to be made to section 7 were not adopted, because they would nullify the certification requirements pertaining to all sources of income.

Section 8

Comment: Section 8 should remove language that does not allow the note to be sold, transferred, assigned, or pledged without HUD’s prior written approval. HUD does not evaluate

the original payee of a surplus cash note, so why would evaluation of a successor payee be necessary? HUD approval would place an unnecessary burden on the payee and HUD field offices.

HUD response: The information required by section 8 is necessary to protect HUD's interest.

Section 9

Comment: Section 9 should be removed. HUD should allow for the compounding of interest in order to give the parties to the surplus cash note more flexibility. Since HUD does not regulate the interest on surplus cash notes, it should not matter to HUD that such interest is compounded.

HUD response: HUD does not allow interest to compound because it would create an insurmountable amount of debt owed by Mortgagor, since the Surplus Cash Note becomes due upon the payoff of the HUD-insured mortgage.

Performance Bond – form 92452M

Comment: Generally, many provisions extend the surety's risk beyond what is normally contemplated in the surety's underwriting and premium. Such an expansion of risk ultimately results in greater construction costs for the project owner.

HUD response: HUD has not made any substantive changes to the Performance Bond document from the existing version currently in use, which has performed satisfactorily.

Section 3 – Increase of Obligation

Comment: Increasing the obligation of Obligor by any approved increase in the contract price would increase the surety's exposure beyond typical levels, which is normally limited by the penal sum of the bond. This provision should be eliminated or subject to

negotiation by the surety, particularly since section 9 waives the Surety's notice of any increase.

HUD response: Section 3 reflects the language of the Performance Bond currently in use. The cost of any increase in Surety's exposure may be addressed in a rider to the Performance Bond, which specifically provides a check-off for whether or not there are riders to the bond.

Section 4 – Contractor's indemnification

Comment: This form lacks the AIA A311 (1970) provision that requires a Contractor to be formally declared by the Owner to be in default under the Contract.

HUD response: HUD considers this issue to be sufficiently covered by the document. Section 2 states that Lender desires protection in event of default by Contractor under the Contract. Section 4 refers to all expenses that any Obligee may incur in making good any such default. AIA A311 (1970) is no longer published; it has been replaced by AIA A312-1984.

Comment: The wording "all costs and damages" is substantially broader than industry standard forms.

HUD response: As noted previously, HUD has not made any substantive changes to the Performance Bond document from the version currently in use.

Comment: There is no requirement that costs incurred by the Obligee are "reasonable," and it could be construed to include such items as attorney's fees.

HUD response: HUD considers that the law of the Property Jurisdiction would govern as to what costs are indemnified.

Comment: The four options that a Surety traditionally has in the event of a declared default under the Contract are severely limited.

HUD response: As noted previously, HUD has not made any substantive changes to the

Performance Bond document from the version currently in use, which has performed satisfactorily.

Section 5 – Surety’s Liability to Oblige

Comment: The requirement that Surety only, not the Principal, notify Oblige in writing if Oblige fails to make payments or perform obligations under the Contract, and giving the Oblige a reasonable period of time to cure such failure, deviates from industry standard in AIA A311.

HUD response: As noted previously, HUD has not made any substantive changes to the Performance Bond document from the version currently in use. AIA A311 no longer is published.

Comment: This provision eliminates the incentive to make timely payments.

HUD response: Rather than eliminating the incentive to make timely payment, HUD considers Section 5 to provide Owner and Lender a period to cure their failure to make payments, consistent with HUD regulations that provide a 30-day grace period before declaration of a default.

Comment: The last sentence, which requires Surety to monitor the Oblige’s performance, should be removed.

HUD response: Providing Obliges with an opportunity to cure a failure to pay or perform before a Surety shall be liable under the Performance Bond protects the Project from premature and unintended default. HUD insists on a grace period to avoid such outcomes. Given the involvement and possible economic loss to the Surety coupled with the defense available to the Surety, the Surety would be in the best position to monitor the payments made by the Obliges.

Section 7 – Surety’s Subrogation Rights

Comment: Provision that “No amounts paid to the Owner without the written consent of the Lender shall reduce the liability of Surety to Lender under this Performance Bond” is unusual and deviates from the industry standard. What happens if the Lender refuses or unreasonably delays to give written consent?

HUD response: As noted previously, HUD has not made any substantive changes to the Performance Bond document from the existing version currently in use. Surety makes payments that are not in accordance with the terms of the Bond at its own risk.

Comment: This provision could place the Surety in the middle of Lender-Owner disputes and increase the bond penalty amount above the limit stated in the bond. This may result in the Surety’s violation of various regulatory mandates.

HUD response: HUD disagrees with the comment. The intended effect of the provision is to allow Surety to wait until Lender and Owner settle their disputes before making payment.

Comment: This provision wrongly places on the Surety the responsibility to manage the flow of funds between Lender and Owner.

HUD response: Rather than requiring management of the flow of funds by Surety, this provision requires no action by Surety, other than to obtain Lender’s consent before making payment to owner.

Section 9 – Waiver of Notice

Comment: This section should be revised to provide notice of more than 10 percent change in price and requiring Surety’s consent to increase penal sum in Bond for increases exceeding 25 percent.

HUD response: As noted previously, the cost of any increase in Surety’s exposure may

be addressed in a rider to the Performance Bond.

Payment Bond, form HUD – 92452M

Prefer Current Document

Comment: The existing Payment Bond closely parallels AIA A311 (1970), which is an industry standard, and should continue to be used.

HUD response: As noted previously, AIA A311 is no longer published.

Missing Provisions

Comment: Provisions that would constitute a statutory payment bond under California law are missing.

HUD response: HUD acknowledges that the closing documents when used in different states may require amendment for purpose of compliance with different state laws. Such a process is contemplated in section 29 of the Lender's Certificate, which addresses changes in the closing forms.

Comment: There is no express requirement that labor, materials, and equipment furnished for use be directly applicable to the Contract.

HUD response: Section 2 expressly provides that the sum, as noted, is to pay for labor, materials, and equipment furnished for use in the performance of the Contract.

Comment: There is no express requirement that the Surety has waived notice of changes to the Contract.

HUD response: Such a waiver appears in section 7 of the Payment Bond.

Comment: There is no express requirement that no amounts paid to the Owner without the written consent of the Lender shall reduce the liability of the Surety to the Lender under the Bond.

HUD response: Such a requirement appears in section 6 of the Payment Bond.

Comment: The definition of Claimant is broader in the existing form.

HUD response: The term Claimant is not used in the current form HUD-92452A.

Contrary Provisions

Comment: A number of the bond provisions (e.g., statute of limitations, what constitutes a claimant, release of bond provisions) are contrary to the rights of claimants under California law.

HUD response: As noted previously, HUD acknowledges that the closing documents when used in different states may require amendment for purpose of compliance with different state laws. Such a process is contemplated in section 29 of the Lender's Certificate, which addresses changes in the closing forms.

Comment: Provisions for adding obligees are unnecessary, as payment bond runs only to claims qualifying as mechanic's lien (at least in California).

HUD response: Adjustments to the documents may be made as required to meet the legal requirements of different jurisdictions.

Additional Surety Rider

Comment: The requirement of prior HUD approval for an additional surety is contrary to statute (31 U.S.C. 9304-9305) and implementing regulations of the Department of the Treasury that address the parameters of a surety's authority to write bonds required by U.S. law. Under 31 CFR 223.10, a surety may write a bond in excess of its underwriting limitation if a co-surety joins the bond and the bond amount is no more than the combined underwriting limitations of the co-sureties. This regulation does not provide an agency the ability to foreclose this option.

HUD response: The fact that law permits an additional Surety does not prevent HUD from exercising its authority to approve the additional Surety. HUD must be apprised when the required bond exceeds the underwriting authority of the Surety.

Section 2

Comment: Section 2 is similar to section 3 of the Performance Bond, and the same comments are applicable.

HUD response: The same HUD comments, respectively, are applicable.

Section 6

Comment: Section 6 is similar to section 7 of the Performance Bond, and the same comments are applicable.

HUD response: The same HUD comments, respectively, are applicable.

Comment: A provision regarding payment to the owner under the Payment Bond is not applicable, because Claimants would be the exclusive recipients of payments under the Bond.

HUD response: An Owner would qualify as a Claimant under section 9, which generally defines a Claimant as one having a direct contract with Contractor or with a subcontractor of Contractor for labor, materials, or equipment used in the performance of the Contract.

Off-Site Bond, form HUD-92479M

Comment: Several provisions (e.g., Surety waives all notices of changes, any increase in the Off-Site Contract price increases accordingly the monetary obligation of Obligor, and the amount of time the Owner can pursue damages) deviate from industry standard.

HUD response: The issues noted have been addressed in the context of the HUD responses to comments on the Performance Bond and the Payment Bond.

Escrow Agreement for Latent Defects, form HUD-92414M

Comment: This agreement leaves out the contractor, whose money or letter of credit funds the escrow in most cases, who was responsible for the work, and who has the contractual relationship with the subcontractors and material suppliers who would be called upon to correct the problem.

HUD response: HUD does not intend to rely exclusively upon the original Contractor, who may no longer be extant when the latent defects need to be addressed.

Escrow Agreement: Additional Contribution by Sponsors for Operating Deficit, form HUD-92476a-MGeneral

Comment: The name of the document should be changed to “Escrow Agreement for Operating Deficit,” to reflect that the escrow may not be funded by the sponsor.

HUD response: HUD agrees with the commenter and has changed the name of the document accordingly.

Comment: The language should be made consistent, wherever possible, with the Escrow Agreement for Working Capital.

HUD response: HUD has reviewed both documents in final form and does not believe that the two documents are inconsistent with each other. They are different documents with different purposes and therefore to the extent terminology is different, such difference is appropriate.

Section 5

Comment: A section should be added that the Lender may draw against any letter of credit and convert it to cash to be held and disbursed as part of the Deposit.

HUD response: Section 5 of the document already contains the language recommended by the commenter.

Comment: The requirement in section 5 that the Lender provide cash to cover a letter of credit, which cannot be converted to cash, is a matter between HUD and the Lender, addressed in the Mortgagee's Certificate. This language is not included in the current form, is inappropriate, and should be removed.

HUD response: HUD disagrees and believes that this provision is appropriate for the Escrow Agreement for Operating Deficit.

Comment: The language in section 5 regarding bonds is obsolete and should be removed.

HUD response: HUD agrees with this comment and has removed the reference to bonds in section 5.

Comment: The language of section 5 should be replaced with language that allows for the lender to hold and disburse the Deposit at the sole direction of HUD.

HUD response: HUD disagrees and believes that the language, which provides for the Depository to hold and disburse the escrow at the sole discretion of HUD, is appropriate.

HUD Amendment to AIA Document B181, HUD-92408M

Heading

Comment: The document heading should be changed. This document will typically be signed before an application for mortgage insurance is submitted to HUD. Therefore, it is impractical to include the HUD Project number.

HUD response: HUD did not adopt this recommendation. Although AIA Document B181 will typically be signed before an application for mortgage insurance is submitted to HUD,

the HUD Amendment would not be executed at that time. The HUD Amendment is part of the insurance application process. It is important, and not impractical, to include the HUD Project number at that point.

Section 1

Comment: In section 1, a definition of “Original Owner” should be added and used in the document to reflect that the Owner-Architect Agreement is often signed by an affiliate of the Borrower. A definition of “HUD” also should be added.

HUD response: HUD considers a definition of Original Owner not to be necessary and has not adopted this recommendation. HUD also believes that the acronym “HUD” does not require a definition, since the header for the document states “U.S. Department of Housing and Urban Development.” In addition, the prefatory section now specifies the definitions in the “Regulatory Agreement” and “Security Instrument” are applicable.

Section 3

This section has been redesignated as section 4.

Comment: In section 3, language should be added to allow Agreement to be assigned from the Original Owner to Borrower without HUD consent.

HUD response: As the insurer of the mortgage, it is important for HUD to be apprised of and approve any changes in circumstances that would affect HUD’s interest. HUD declines to adopt this change.

Comment: Language requiring Owner not to contract with disbarred individuals/firms should be removed. Requirements of this type applicable to the Borrower should be included in the mortgage insurance application or regulatory agreement rather than as an addendum to an agreement between two private parties.

HUD response: HUD disagrees with this comment. At the time this document is executed as part of the mortgage insurance application, Owner is Borrower, and it is important to retain this language in this document.

Section 4

This section has been redesignated as section 5.

Comment: Sections 4 and 12 should include language to provide that the Architect cannot withhold documents due to nonpayment for reimbursable expenses, termination expenses, and fees for additional services, collectively referred to as “additional payments.”

HUD response: HUD disagrees with this comment. This concern is adequately addressed in section 12, and additional clarification is not necessary.

Section 8

This section has been redesignated as section 9.

Comment: Section 8 is too broad. It is not accurate to say that “any action or determination by either the Owner or the Architect is subject to acceptance by the Mortgagee and by HUD,” particularly during the period prior to initial closing.

HUD response: HUD disagrees with this suggested change. Redesignated section 9, as currently worded, is necessary to protect the interest of the Lender and HUD. In addition, the introductory language of the HUD Amendment, now redesignated as section 2, specifically provides that, “The provisions of this Amendment supersede and void all inconsistent provisions that may exist between this Amendment and the Agreement.”

Section 10

This section has been redesignated as section 11.

Comment: In section 10, the parties identified for identity-of-interest purposes should

include “managers” and “members.”

HUD response: HUD agrees with this comment and has made this change in all documents where the identity-of-interest provisions appear.

Section 12

This section has been redesignated as section 13.

Comment: In section 12, the references to Section 202/811 should be removed.

HUD response: HUD disagrees, because this document is frequently used in Section 202/811 transactions.

Certification

Comment: The separate certification has no purpose.

HUD response: HUD disagrees. The certification in the Amendment is needed to verify the validity of representations made and provides an enforcement tool if such representations are not in fact true.

Comment: There is no reason to have HUD sign a certification.

HUD response: HUD agrees with this recommendation, and a HUD representative no longer appears as a signatory.

V. Findings and Certifications

Paperwork Reduction Act.

The proposed new information collection requirements contained in this notice have been submitted to OMB for review under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). Under this Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information, unless the collection displays a valid control number.

The public reporting burden for this new collection of information is estimated to include

the time for reviewing the instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

Information on the estimated public reporting burden is provided in the following table:

Estimated burden hours and costs to the respondents:

Information Collection	Number of Respondents	Frequency of Response	Responses Per Annum	Burden Hours Per Response	Annual Burden Hours	Hourly Cost	Total Annual Cost
HUD-91710M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-91712M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92023M	600	1.00	600	1	600	\$26	\$15,600
HUD-92070M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92223M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92408M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92412M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92413M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92414M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92450M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92452A-M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92452M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92455M	600	1.00	600	1	600	\$26	\$15,600
HUD-92456M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92457A-M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-9257M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-9464M	600	1.00	600	1	600	\$46	\$27,600
HUD-92476.1M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92476A-M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92477M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92478M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-92479M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-91725M	600	1.00	600	1	600	\$125	\$75,000
HUD-91725M-CER	600	1.00	600	1	600	\$46	\$27,600
HUD-91725M-INST	0	0	0	0	0	0	0
HUD-92434M	600	1.00	600	1	600	\$26	\$7,800
HUD-92441M-SUPP	600	1.00	600	0.75	450	\$26	\$11,700
HUD-92441M	600	1.00	600	0.75	450	\$26	\$11,700
HUD-92442M	600	1.00	600	1	600	\$58	\$34,800
HUD-92466M	600	1.00	600	1	600	\$58	\$34,800
HUD-92466M-HCFRA	600	1.00	600	0.75	450	\$26	\$11,700
HUD-92554M	600	1.00	600	0.5	300	\$26	\$7,800
HUD-94000M	600	1.00	600	0.75	450	\$26	\$11,700
HUD-94001M	600	1.00	600	1	600	\$26	\$15,600
HUD-93305M	600	1.00	600	0.5	300	\$26	\$7,800
Totals					13,500.00		\$433,831.00

The hourly rate is an estimate based on an average annual salary of \$62,000 for developers and mortgagees.

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting comments from members of

the public and affected agencies concerning the proposed collection of information to:

- (1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- (2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
- (3) Enhance the quality, utility, and clarity of the information to be collected; and
- (4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Comments must be received by **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Comments must refer to the proposal by name and docket number (FR-5354-N-01) and must be sent to:

HUD Desk Officer
Office of Management and Budget
New Executive Office Building
Washington, DC 20503
Fax number: (202) 395-6947

and

Leroy McKinney Jr.
Paperwork Reduction Act Program Manager
Office of the Chief Information Officer
Department of Housing and Urban Development
451 Seventh Street, SW
Room 4178
Washington, DC 20410

VI. Solicitation of Public Comments

Section IV of this preamble, which discusses and presents HUD's responses to public comments, highlights the many changes that HUD made to the closing documents in response to public comment. HUD welcomes public comments from industry and other interested members of the public on this most recent issuance of revised closing documents, posted at www.hud.gov/offices/hsg/mfh/mfhclosingdocuments.cfm.

Dated: January 12, 2010

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David H. Stevens, Assistant Secretary for
Housing – Federal Housing Commissioner

[FR-5354-N-01]