

OAHP Headquarters
Guidance on Underwriting Issues
Pre-Existing Loans and/or Obligations
(Tertiary and Subordinate Debt)

This memo addresses underwriting issues that affect projects with pre-existing loans and obligations (Pre-Existing debt). This guidance replaces the previous Broadcast titled “**Pre-M2M HUD-Held Debt Subject to a Workout**” issued 6/23/2004. Changes from the previous guidance include expanded identification of roles and responsibilities and incorporation of subsequent Resource Desk broadcasts concerning OGC review of subordinated debt.

Background Pre-Existing Debt:

OAHP is defining pre-existing debt as any obligation of the property or the partnership that is non-FHA insured that exists pre-restructuring. Pre-existing debt that will continue to exist post restructuring is a significant problem that historically has delayed a successful closing. For the purposes of an OAHP restructuring plan it does not matter whether the note is secured by the property or unsecured. Examples of pre-existing debt include, but are not limited to: Flex Sub notes (see also Appendix P), loans secured by the partnership interests, residual receipt notes, wrap notes, land installment sales contracts, loans made by the partners, workout related debt, denied accounts payable (not written off) and loans made by public entities that may be grants in disguise.

General Policy Statement on Pre-Existing Debt

All pre-existing debt must be verified with the applicable Multifamily HUB or Program Center to determine if HUD ever approved it. If not, it must be resolved by the owner to HUD’s satisfaction prior to closing.

Any identified debt that will survive post closing must be the subject of a new Subordination Agreement. The draft Subordination Agreement must be reviewed and/or prepared by PAE counsel and reflect the agreement of the owner and subordinate lien-holder with respect to such debt (e.g. the modification of the payment obligation and maturity date) and then be submitted to the OAHP HQ Closing Department for OGC review. Documents at a minimum must be received in OAHP HQ 30 days prior to an estimated closing date, but with more lead time recommended depending on the anticipated cooperation of the lien-holder. The submission must include copies of the note, mortgage or any other debt instrument being subordinated.

Subordinated debt and indications of OGC review must also be noted on Form 7.4 as part of the claims package submission.

Workouts

In the past, when a lender assigned first mortgage debt to HUD after a default, the UPB and delinquent interest were occasionally restructured into multiple senior and subordinate notes under the terms of a workout agreement. Workout related debt can be identified by the FHA number and the suffix A, B, C, and/or D. A search in the Real Estate Management System (REMS) under the Loan Information tab will list all related debt on a property, including any

subordinate debt. The PAE should request copies of active notes and modifications from the mortgagor and mortgagee as the specific terms of these loans vary widely by deal.

Occasionally workout related debt can be included in the restructured claim amount. Although we cannot provide hard and fast rules, a second mortgage (“B” or “C” piece) that is current and fully amortizing pre-M2M, that clearly has a lineage to a FHA insured mortgage would be a candidate for inclusion in the restructuring. The PAE should request copies of the notes and modifications from the mortgagor and mortgagee as the specific terms of these loans vary widely by project. The documents must be forwarded to the Debt Restructuring Specialist who will forward them to OGC for review during the underwriting phase of a restructuring. Submissions without an OGC analysis will be returned.

The final decision whether workout debt should be included in the M2M debt restructuring or subordinated rests with the Preservation Office Director, subject to Committee review if appropriate. Occasionally debt may be written off and the Preservation Office Director should forward any recommendation to OAHP Headquarters for review and approval by the Deputy Assistant Secretary.

Underwriting Guidelines

All previously HUD approved loans must be addressed by the PAE during the restructuring, in the “Notes” section on the LOAN INPUT page of the underwriting model. Except for some workouts as discussed above, they cannot be included in the “UPB For Loans To Be Restructured” on line 56-61. The loan amounts **may not be included** in the restructured debt.

The RC conditions page of the model should specifically identify each individual loan/account that will be the subject of a subordination agreement or a required write-off. OAHP Reviewers must also transcribe this information to the Transaction Review and Approval Form.

These loans must be addressed in the RC with specific terms and conditions for modification and subordination of the debt. It is critical that the PAE requires in the RC that the PAE attorney review the existing documents and submit drafts for HUD review prior to closing.

Responsibilities

Although the above sections discuss the role of the PAE, Closing Department and OGC, it is critical that the Debt Restructuring Specialist (DRS) is actively involved in the process. The DRS must ensure documents are gathered, reviewed and consistent with the approved restructuring plan. PAEs also do not have access to REMS; consequently in the underwriting phase the DRS must ensure the PAEs have copies of required screens. Most importantly the DRS must ensure documents are shepherded to the appropriate party timely, well in advance of the next milestone due date.

Contacts

Any questions about this process should be forwarded to: Patricia Toadvine or Norman Dailey.