

# Appendix N:

## Section 223(a)(7) Guidance for Full Restructuring Transactions

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A. **Applicability:** This guidance addresses only the processing of new FHA-insured mortgages under Section 223(a)(7) for Fulls. This guidance does not apply to 223(a)(7) processing of Lites.

B. **Overview of the Process:**

1. Early in the restructuring process, the owner finds a HUD-approved multifamily mortgagee (Lender) to provide take-out financing.
2. PAE and owner provide the Lender information regarding the restructuring for use in preparing the application for mortgage insurance. The Lender and the PAE work closely together to ensure consistency between the 223(a)(7) application and the Restructuring Plan.
3. Lender prepares and submits an application package (including the draft firm commitment) for FHA insured financing to the PAE.
4. PAE reviews the 223(a)(7) application package for consistency with the draft Restructuring Plan and submits the application, with a recommendation, to OMHAR.
5. OMHAR reviews and issues a Firm Commitment for mortgage insurance.
6. PAE organizes simultaneous closing of 223(a)(7) take-out financing and the M2M restructuring transaction.

C. **Additional Guidance on Eligibility:**

1. **HUD-held Loans** - Refinancing of HUD-held mortgages is not eligible under 223(a)(7).
2. **Currently Coinsured Loans** are eligible for refinancing under 223(a)(7) in accordance with this guidance. No special processing is required. Some documentation typically available to the PAE in the local HUD office files will be found instead in the Coinsuring Lender's project file.
3. **Supplemental Loans** - HUD insured supplemental financing (e.g., Section 241 loans) may be included in the new 223(a)(7) insured loan if required in the Restructuring Plan. Currently HUD-held supplemental loans or direct loans from HUD (e.g., Flexible Subsidy) are not eligible for inclusion under 223(a)(7).
4. **Substantial Rehabilitation** - 223(a)(7) is not appropriate when substantial rehabilitation is involved. Consider Section 221(d)(4), conventional financing or HFA Risk Sharing. Substantial rehabilitation is defined as:

- a) Cost of repairs, replacements and improvements exceeds the **greater of**:
    - i) 15 percent of the estimated value after completion of all required repairs, replacements, and improvements, **or**
    - ii) \$6,500 per dwelling unit adjusted by the local HUD Hub or Program Center high cost percentage for that area, **or**
  - b) Involves the replacement of 2 or more major building components.
5. **Change in Mortgagor** - 223(a)(7) is a refinance program only and will not accomplish transfer of ownership to a new mortgagor entity. In some instances, however, the Restructuring Plan will include a transfer of ownership. A separate Transfer of Physical Assets (TPA) request must be submitted by the mortgagor to the PAE and processed in accordance with guidance in Appendix D to accomplish a change in ownership.
- a) Preliminary approval of the TPA must be issued by OMHAR prior to closing the debt restructuring transaction.
  - b) Upon preliminary approval of the TPA, the existing deed, mortgage, note and Regulatory Agreement must be assigned to the new mortgagor. (This accomplishes the sale of the property and is not part of a 223(a)(7) refinance transaction. It must be accomplished no later than immediately prior to closing the 223(a)(7) loan.)
  - c) Thereafter, when closing of the 223(a)(7) refinance and the Restructuring Plan occurs, recording of all documents may occur simultaneously.
- D. **Lender:** Must be a HUD-approved multifamily mortgagee. We recommend that the owner select a Lender with recent experience processing 223(a)(7) applications.
- E. **Underwriting Requirements:**
- 1. **Ensure consistency between the Restructuring Plan (including exhibits) and the 223(a)(7) application**, including, but not limited to, the following:
    - a) Income and expense estimates, vacancy and collection loss etc.
    - b) Minimum owner contribution/cash requirement.
    - c) Deposits to the reserve for replacement (both annual deposits and any initial deposit at closing).
    - d) Work write-up and other terms for any rehab/repair escrow.
    - e) Post rehab/repair value.
  - 2. **Environmental Assessment and Lead-Based Paint Testing and Abatement** - The Environmental Review and Assessment (EA) performed as part of OMHAR's restructuring analysis satisfies Housing's environmental requirements. Lead-based paint (LBP) requirements are addressed in the EA and are consistent with Housing's revised LBP regulations published September 15, 1999. (Note: Housing will be revising outstanding guidance in H93-89 to reflect these regulatory changes.)

3. **First Mortgage Limitations** - The loan amount must not exceed the least of the following (rounded down to the nearest \$100 multiple):
  - a) **Restructuring limitation:** the loan amount identified in the Restructuring Plan.
  - b) **LTV limitation:** 100% of Value.
  - c) **Debt Service Coverage limitation:** The loan amount supported by NOI based on a debt coverage ratio determined by the PAE (generally between 1.2 and 1.4 but in no event lower than 1.11 DSC for profit motivated or 1.053 for non profit mortgagors).
  - d) **UPB limitation:** the UPB prior to the restructuring. Note: if a waiver of this limitation has been approved by OMHAR HQ, contact Jo Anne Garrison at (202)708-3856 X3651 for guidance on specific changes in 223(a)(7) processing as addressed in this Appendix.
4. **Maximum Loan Term** - Must not exceed the lesser of:
  - a) 12 years beyond the remaining loan term at the time of restructuring, or
  - b) the original loan term (e.g., 35 years if 223(f), 40 years if 221(d)(4)), if the original mortgage has been in place less than 12 years, or
  - c) the remaining life of a partnership under the Partnership Agreement, (as extended), or
  - d) 75% of remaining economic life of the project.
5. **Repair/rehab Escrow** - Use the work write-up and cost analysis included in the Restructuring Plan to establish the repair/rehab escrow.
  - a) The required escrow must be at least 110% of the PAE's estimate of the cost of repairs/rehab.
  - b) The entire escrow must be funded in cash at closing.
  - c) Use the M2M Repair/rehab Escrow Agreement.
    - i) Any HUD funds remaining after completion of required repairs (and acceptance by the PAE and provision of latent defects warranties, if applicable) may be used to finance additional repairs if approved by the PAE or HUD. If not approved, these funds shall be applied to the HUD-held second mortgage or Reserve for Replacement account.
    - ii) The owner may request return of the owner's proportionate share of funds remaining after completion (generally at least 20%).
  - d) The PAE will work with the lender to make the determinations required in Chapter 4-10.
6. **Operating Deficit Escrow** – We do not anticipate a need for an initial operating deficit as a result of restructuring most transactions. However, if the PAE determines there will

be lost income during the repair period, a separate operating deficit escrow must be established at closing (cannot be included in the rehab/repair escrow). The PAE should use Form FHA-2476-A, Escrow Agreement - Additional Contribution by Sponsors for this escrow.

The requirements of the M2M Repair/rehab escrow agreement detailed above apply to this escrow as well.

7. **Regulatory Agreement** - A new Regulatory Agreement must be executed at closing under the same Section of the Act as the original loan was insured, (if previously coinsured, use the Regulatory Agreement of the same *full insurance* Section of the Act). The Restructuring Commitment will require execution of a M2M Modification of that Regulatory Agreement.
8. **Impact of other HUD required use restrictions (236, 221(d)(3) BMIR or Flex) on 223(a)(7) processing** - If the application involves a mortgage originally insured pursuant to 236 or 221(d)(3) BMIR, or the project received HUD Flexible Subsidy Program direct loan funds as a Capital Improvement Loan, the project must continue to operate under the use restrictions imposed by those programs through their Regulatory Agreements. Those restrictions are already considered in the M2M restructuring transaction and do not require further consideration in processing the 223(a)(7) application.
9. **Re-use of Interest Reduction Payments (IRP) on 236 Loans** - The PAE will generally propose to re-use IRP remaining from an original Section 236 loan. (Refer to Appendix Q, [Mark-to-Market Requirements for 236 Transactions and Re-use of IRP](#) for specific processing requirements and closing issues.) The Revitalization Plan will reflect the specific proposal for each transaction, either:
  - a) **to support additional debt** by direct payments from HUD to the mortgagee for debt service (see paragraph V.C.3. and instructions for form HUD-92264A), OR
  - b) **to increase Reserves by payment of the IRP for deposit into the Reserve for Replacement** account. The required deposit to the reserve reflected in the Firm Commitment should identify the portion of the required deposits to the reserve, which will be funded through IRP.
10. **Use Agreement** - The 223(a)(7) mortgage will be subordinate to the M2M Use Agreement.
11. **Cost Certification** - Cost certification is not required.
12. **Property Insurance Requirements** - To ensure that projects have adequate hazard/fire and extended coverage insurance, an updated estimate of the project's Total (100%) Insurable Value (using form HUD-92329) will be developed as part of the 223(a)(7) commitment process. **Attachment 5** addresses completion of the form.

**F. Fees:**

1. **HUD Processing/application Fee** - The HUD application fee of .3% of the insured loan amount for 223(a)(7) applications has been waived for Full restructuring transactions which were in the OMHAR pipeline 1/31/2001. Since these are project specific waivers, it will be necessary to contact the Resource Desk to verify approval of a waiver if the application is for a project that enters the OMHAR pipeline after that date.
2. **HUD Inspection Fee** - None
3. **Financing Fees** - Financing fees must be reviewed for reasonableness by the PAE and OMHAR in developing the Restructuring Plan.
4. **MIP** - An up-front MIP (generally .5 (half of one) percent of the loan amount) must be paid to HUD at closing and will be treated as a transaction cost in the Restructuring Plan. Thereafter, annual MIP of .5% of the loan amount will be collected with monthly debt service payments.

**G. Application Submission and Processing:**

1. **Relationship to M2M Restructuring Transaction** - PAE underwriting forms the basis for the application for mortgage insurance (e.g., rents and expense data).
  - a) The owner and PAE share this information with the Lender for its consideration in developing the application for mortgage insurance.
  - b) If the owner plans to sell the project as part of the debt restructuring transaction (see TPA in paragraph III. D., above), the seller must cooperate with the purchaser in developing and submitting the 223(a)(7) application. The 223(a)(7) application exhibits and processing should reflect the new mortgagor entity (the purchaser).
2. **Application Package** - The Lender will provide input to the owner and PAE on takeout financing terms. The Lender will then use the draft Restructuring Plan and supporting information to develop the 223(a)(7) application package for submission to the PAE.
  - a) **Timing.** The application should generally be submitted no later than 30 days prior to the anticipated date of issuance of the Restructuring Commitment (usually 90 days prior to closing).
  - b) **Submission to the HUD Hub or Program Center.** The Lender should simultaneously submit a copy of the completed application form HUD-92013 to the HUD office with jurisdiction for entry into HUD's data systems (DAP).
  - c) **Application Package Cover Letter.** The cover letter should indicate that the application conforms to the critical terms of the draft Restructuring Plan and identify the date of the draft on which the application was based. In addition:
    - i) If there are discrepancies, these should be specifically identified and explained (i.e., identify changes agreed to but not yet documented in writing by the PAE).

- ii) If the Restructuring Plan reflects a change in the mortgagor entity, provide the names of both entities in the cover letter and:
    - Reflect the new mortgagor entity (the purchaser) only in the 223(a)(7) application exhibits and processing.
    - Verify that a TPA package has been submitted to the PAE.
  - d) **Form HUD-92013**, with only Sections A, B, C, K, and M completed. Form must be prepared and signed by the owner and Lender.
  - e) An Unsigned draft of FHA firm commitment, including **Form HUD-92264A, in letter format**, completed by the Lender. A sample firm commitment is attached in **Attachment 3**. Submit both electronic file and hard copy to the PAE. The electronic file (in WORD or Wordperfect) may be submitted on disc or as an attachment to an email to the PAE.
  - f) Submit a hard copy of Form HUD-92264A completed in accordance with Attachment 1. An optional, fillable EXCEL file version of the form HUD-92264A for 223(a)(7) processing of M2M Fulls will be posted as **Attachment 6**. Use of this electronic format is recommended but not required. The file contains specific guidance on where to locate data in the M2M Underwriting Model, version 3.2 and performs many of the math functions automatically. Note that in order to complete Part III. of form HUD-92264A, the Lender must verify that the owner has adequate funds available to close the transaction.
  - g) For any new principal of the mortgagor entity (defined as any new general partner, limited partner with a 25 percent or more interest, stockholder with a 10 percent or more interest) being added to the mortgagor entity and not already being processed through a TPA, the Lender must submit both:
    - i) **original of commercial credit report** ordered by the Lender on the new principal, and
    - ii) **completed Form HUD-2530** on the principal (refer to Handbook 4065.1).
  - h) **Byrd Amendment** (lobbying) disclosure forms.
  - i) **Form HUD-92329, Property Insurance Schedule** completed in accordance with the modified guidance in Attachment 5.
3. **Receipt of the Application Package by the PAE and HUD Office**
- a) **PAE contacts the local HUD Hub or Program Center** with jurisdiction for assignment of a new FHA insured project number. The PAE must provide the original project number and Section of the Act (SOA) under which the project was originally insured or coinsured.
  - b) **HUD assigns the project number** in accordance with normal procedures. (Note: if previously coinsured, HUD will assign the next number under the full insurance SOA analogous to the Section under which it was originally coinsured.)

- c) **HUD enters the application data into DAP.**
  - i) Enter "M2M", in the "Notes" field in the DAP tracking module. This should be entered as the first item in the remarks box and remain in first position until the indicator boxes become available in subsequent releases of DAP and information is transferred to them.
  - ii) M2M 223(a)(7) deals need to be identifiable in DAP so they can be excluded from Housing's future analyses of credit subsidy.
  - iii) Questions on DAP entries may be directed to Gina Flynn, (202) 708-0614 X2534.
- 4. **Processing and Review of Application** - The PAE will review the application package and provide recommendations to OMHAR. The PAE is responsible for working with the Lender and owner to assure that an approvable application, consistent with the Restructuring Plan is developed. If the application is non-responsive or inadequate (e.g., incomplete or at variance with the draft Restructuring Plan), the PAE may return it to the Lender for resubmission.
  - a) **PAE forwards forms HUD-2530 to HUD for processing** if applicable (see paragraph VII.B. 6. above). In these cases, HUD will process 2530 clearance and provide the PAE with copies of the 2530 approval or rejection.
  - b) **Specific PAE Processing Requirements** -
    - i) **Repair Escrow** - The draft firm commitment must address the requirements for the repair/rehab escrow as required in the Restructuring Plan. (See Chapter 4.)
    - ii) **Operating Deficit Escrow** - If the PAE has determined that an operating deficit escrow is required, provide the operating deficit escrow analysis (number of months of lost income, rental income by unit type, total estimated loss of) in Section IV, Remarks, of form HUD-92264A. Refer to paragraph V.F. for specific requirements.
    - iii) **Credit worthiness of New Principals** – If there are any new principals of the mortgagor entity, not already being processed through a TPA, the PAE must do a credit analysis of the new principals. The PAE must review the Credit reports on the new principals provided by the Lender in the application. (Refer to Handbook 4470.1 REV-2 CHG 1, Chapter 2 for guidance on review of credit data.) To be acceptable, any new principals must pass 2530 clearance through the local Hub or Program Center.
    - iv) **Mortgagor's Ability To Meet Settlement Requirements** - The PAE must determine that the owner has adequate funds available to close the transaction.
    - v) **Property Insurance Requirements** - Ensure that form HUD-92329 Property Insurance Schedule, is submitted with the application and completed in accordance with the guidance in Attachment 5.

- c) **PAE Review of Lender's draft Firm Commitment and form HUD-92264A**
- i) The PAE should pay particular attention to:
    - Commitment amount and loan terms,
    - Special conditions of the commitment,
    - Term of the firm commitment (which should be coterminous with the Restructuring Commitment but must not exceed 90 days), and
    - Form HUD 92264A for compliance with program requirements (see **Attachment 1** for specific guidance).
  - ii) PAE modifications to the Lender's conclusions should only be recommended to OMHAR if they have been mutually agreed upon by the Lender and PAE.
  - iii) The PAE may recommend that OMHAR accept the application or reject it if the application and the M2M restructuring are deemed ultimately infeasible.
  - iv) If the PAE recommends rejection, the PAE will draft a brief rejection letter for the signature of the OMHAR Regional Director, addressed to the mortgagor and Lender.
- d) **PAE Certification.**
- i) Where the PAE, or a related entity or affiliate of the PAE provides the insured takeout financing, the PAE must certify to OMHAR that the specific Portfolio Restructuring Agreement (PRA) requirements applicable to this circumstance have been satisfied; and
  - ii) The PAE must certify to OMHAR that the application package has been reviewed for acceptability:
    - in accordance with the guidance provided in this Appendix, and
    - compared with the draft Restructuring Plan for consistency, and
    - that the conclusions and recommendations provided by the PAE to OMHAR reflect the results of that review.
  - iii) These certifications must be provided in Section IV (page 3) of the form HUD-92264A or by submitting Form 6.2 from the OPG. Project specific comments, conditions and recommendations shall also be provided in Section IV of form HUD-92264A or if additional space is required, in the Remarks section on page 4.
- e) **PAE Submission to OMHAR.** The PAE will submit the original application package with the PAE's analyses, conclusions and recommendations to OMHAR.
5. **OMHAR Review and issuance of Firm Commitment**
- a) **OMHAR will:**

- i) verify that a new insured project number was issued by the HUD office with jurisdiction,
  - ii) verify that the new application data was input into DAP, and
  - iii) where an identity of interest exists between the PAE and mortgagee, specifically review the terms of the financing prior to issuance of a firm commitment.
- b) **OMHAR will review** the PAE's recommendation, the draft firm commitment letter and form HUD-92264A and compare it with the terms and conditions of the Restructuring Plan and Commitment for consistency.
- i) If OMHAR concurs with the PAE's recommendations, the OMHAR Regional Director will sign the Firm Commitment letter and form HUD-92264A and issue them to the Lender with copies to the mortgagor, the PAE and the local HUD Office.
  - ii) If OMHAR is unable to concur with the PAE's recommendations, the OMHAR RO will either return the application to the PAE for revision or modify the conclusions.
- c) **OMHAR will forward** a copy of the firm commitment to the local HUD office (same staff that assigned the project number) so they can update DAP to reflect issuance of the Firm Commitment.

#### H. Closing issues related specifically to 223(a)(7):

1. **Closing** – Closing on the Restructuring Plan and the 223(a)(7) financing must occur simultaneously. Refer to Chapter 7 of the OPG for specific guidance on closing. (See III.E. for closing with a TPA.)
2. **Changes in the terms and conditions of the financing** (e.g., interest rate, etc.) or other provisions reflected in the application impact both the Restructuring Plan and the Firm Commitment. Any changes after issuance of the Firm Commitment must be requested in writing and will be reviewed by the PAE and OMHAR for impact on the Firm Commitment.
3. **PAE Receipt and Deposit of Up-front Mortgage Insurance Premium at Closing** – The up-front, (first year's) MIP must be paid by the mortgagee to HUD at closing. The PAE (or Escrow Agent at the direction of the PAE) will issue a receipt for the MIP and forward the original receipt and check to the HUD lockbox for deposit. See VI.D for guidance on the MIP amount and **Attachment 2** for specific guidance on issuance of the receipt and deposit of the check.
4. **Refunds due from HUD** – Refunds due the mortgagor of unearned MIP paid in advance under the original mortgage may not be deducted from the up-front MIP or other cash requirements at closing (these are tracked by different systems at HUD which do not yet interface). Submission of form HUD-9807, a M2M closing exhibit, initiates the refund process.

5. **Form HUD-290** - At Closing, the PAE Attorney and RO Director sign the form HUD-290, Multifamily Closing Memorandum (see Chapter 7 for specific requirements and contact the Closing Team if you have questions). It is very important that the 290 be submitted to HUD within 5 working days of closing, as this form is required for the new FHA insurance to be put in force. The 290 with attachments (copy of note, copy of receipt for payment of upfront MIP at Closing) must be submitted to HUD, 451 7th St. SW, attention Henry Hodges, Multifamily Insurance Operations Branch room 6260, Washington DC 20005. The OMHAR RO must also provide a copy of the 290 to the local HUD office so that they can update DAP to reflect the Closing.

**List of Attachments:**

**Attachment 1** - Instructions for Completion of form HUD-92264A

**Attachment 2** - Instructions for Receipt of Funds and Refunds

**Attachment 3** - WORD file 223(a)(7) Sample Firm Commitment Format

**Attachment 4** - Fillable version of Official Receipt form HUD-27038 in EXCEL

**Attachment 5** - Instructions for form HUD-92329 Property Insurance Schedule (modified for M2M) Fillable version of form HUD-92329 in EXCEL with M2M Modifications

**Attachment 6** - An Optional, fillable, EXCEL version of form HUD92264A, modified for OMHAR processing of 223(a)(7) applications of M2M Fulls is now available. Use this optional form or complete the standard form available through HUDCLIPS, as modified using the guidance in Attachment 1.