



## U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

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### Special Attention of

**All Multifamily Hub Directors**  
**All Multifamily Program Center Directors**  
**All Multifamily Operations Officers**  
**All Directors of Project Management**  
**All Field Counsel**

## Notice H 2011-05

Issued: February 14, 2011

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Cross References:

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**SUBJECT:** Policies and Procedures for the Deferred Repayment of Operating Assistance Flexible Subsidy Loans

### **I. Purpose**

This Notice sets forth the Department's policies and procedures for approving an owner's request to defer repayment of an Operating Assistance Flexible Subsidy Loan (including HELP Loans) in conjunction with a mortgage prepayment, mortgage expiration, mortgage insurance termination, or the sale of a project (collectively Flex Repay Event). Approval of deferred repayment of Operating Assistance Flexible Subsidy Loans (sometimes referred to as Flexible Subsidy Loans) requires a waiver by the Assistant Secretary for Housing, Federal Housing Administration (FHA) Commissioner, of regulations found at 24 CFR 219.220(b). This Notice supersedes all prior issuances on the subject.

### **II. Background**

Section 201 of the Housing and Community Development Amendments authorized the Department to provide assistance to restore or maintain the financial, managerial, and physical integrity of certain HUD-assisted and HUD-insured projects. The statute authorizes the Secretary to require the benefiting project to be maintained for low- and moderate-income persons for the remaining useful life of the property.

As projects age, owners are seeking to preserve them as a long-term affordable housing resource by taking out loans to repair and upgrade them. Sometimes, however, there are not adequate resources in the refinance transaction to pay the Flexible Subsidy Loan in full, leading owners to request a waiver of the requirement that the Flexible Subsidy Loan be repaid. Some owners have requested deferral of the repayment to the end of the term of a newly obtained mortgage or, in some cases, deferment of the repayment to the end of the term of new affordability restrictions. Some owners have requested forgiveness of the Flexible Subsidy Loan.

The Department understands there is occasionally the need to defer repayments of these loans in order for recapitalization to occur. Therefore, it has developed policy and procedures to allow a repayment deferral where the owner can demonstrate the recapitalization is necessary and there

are not adequate resources in the transaction to pay the Flexible Subsidy Loan in full. In no case, however, will the Department forgive a Flexible Subsidy Loan.

### **III. Applicability**

The regulations at 24 CFR 219.220(b) (1995)<sup>1</sup> require repayment of the Operating Assistance Flexible Subsidy Loan at the earliest of the expiration of the term of the mortgage, termination of mortgage insurance, prepayment of the mortgage, or a sale of the project. Therefore, the policies and procedures in this Notice shall apply to requests for deferral of Operating Assistance Flexible Subsidy Loans at the expiration of the term of the mortgage, termination of the mortgage insurance, prepayment of the mortgage, or sale of the project.

### **IV. Threshold Requirements for a Deferral of Repayment**

For the Department to consider an owner's request to defer repayment of an Operating Assistance Flexible Subsidy Loan, the owner must be in compliance with all business agreements with the Department and project operations must meet HUD standards as demonstrated by:

- A. The project must have a current 60 or above REAC PASS score. If the project received any deficiencies on the last HUD physical inspection, the owner must demonstrate how the deferment and/or refinancing will provide adequate funding to cure the deficiencies. Evidence will include a repair plan that details how all of the physical needs of the project will be addressed and written comments regarding the status of any corrective action in progress, e.g., what repairs have been completed, what other corrective actions have been taken, and target dates for completing these actions.
- B. Owners must be in current compliance with all applicable fair housing and civil rights requirements contained in 24 CFR 5.105(a), including the Fair Housing Act and its physical accessibility requirements, Title VI of the Civil Rights Act of 1964, and Section 504 of the Rehabilitation Act of 1973, and submit a certification of compliance with these requirements as a condition of this deferral request. In addition, owners must not (1) be defendants in a Fair Housing lawsuit filed by the Department of Justice alleging a pattern or practice of discrimination or denial of rights to a group of person raising an issue of general public interest pursuant to 42 U.S.C. 3614(a); (2) be recipients of a letter of findings identifying systemic noncompliance under Title VI of the Civil Rights Act of 1964, Section 504 of the Rehabilitation Act of 1973, or Section 109 of the Housing and Community Development Act of 1974; or (3) be recipients of a charge from HUD concerning a systemic violation of the Fair Housing Act or have received a cause determination from a substantially equivalent state or local fair housing agency concerning a systemic violation of a substantially equivalent state or local fair housing law proscribing discrimination because of race, color, religion, sex, national origin, disability or familial status. Unless the lawsuit, letter of finding, charge or cause

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<sup>1</sup> 24 CFR, Part 219 was subject to streamlining on April 1, 1996; however, 24 CFR Part 219.2 provides a Savings provision for Part 219.

determination has been resolved to HUD's satisfaction before the deferral request, an owner's deferral request will not be considered.

- C. The project must have received satisfactory Management and Occupancy Review ratings for the prior three review cycles. If the project received a less than satisfactory rating in any section of its last Management and Occupancy Review, the owner must provide written comments regarding the status of any corrective action in progress, the other corrective actions taken, and target dates for completing these actions.
- D. The owner is current in the submission of Annual Financial Statements in the form required by the Department and Monthly Accounting Reports for the prior three-year period and Excess Income Reports for the prior seven-year period, and has resolved all compliance flags, if any. All excess income, regardless of the time frame, owed to the Department must be paid in full prior to HUD's approval of the project owner's request to defer the Flexible Subsidy Loan.
- E. The mortgage has been current over the prior three-year period.
- F. There are no outstanding notices of default or violation.

#### **V. Programmatic Requirements**

When requesting a deferral of repayment of an Operating Assistance Flexible Subsidy Loan, the owner must agree to:

- A. Execute and record a Use Agreement that will be superior to all liens, including the refinanced mortgage. The Use Agreement will extend project affordability to 20 years from the date of the original mortgage maturity or the date of full repayment of the fully amortized Flexible Subsidy Loan, whichever is longer. In cases where the underlying mortgage has matured and the owner has not obtained new financing, the term of the re-amortized Flexible Subsidy Loan may not exceed 20 years. The Use Agreement will also provide for continued HUD oversight and monitoring.
- B. Amortize/re-amortize the Flexible Subsidy Loan. The amortization terms of the amended loan, including capitalizing all deferred interest, will be determined by HUD.
- C. Apply all Residual Receipts (or General Operating Reserve for Cooperatives) to the Flexible Subsidy Loan balance at the time of closing the project refinancing or sale.
- D. Apply Reserve for Replacement funds in excess of \$1,000<sup>2</sup> per unit to the Flexible Subsidy Loan balance at the time of project refinancing or sale. It is anticipated that the refinance/sale will provide the funds for all required repairs and upgrades to the property.
- E. If applicable, the owner must agree to amend the Housing Assistance Payments (HAP) Contract to include language that requires electronic submission of Annual Financial

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<sup>2</sup> The \$1,000 per unit figure is the typical floor for Reserve for Replacement Accounts. The analysis at the time of the deferral request may require a higher or lower floor.

Statements and adherence to the REAC Physical Inspection standards.

**VI. Terms for the Modified Operating Assistance Flexible Subsidy Loan**

The terms of the modified Flexible Subsidy Loan shall be as follows:

- A. The interest rate shall remain the same as the rate on the existing Flexible Subsidy Loan. The Hub/Program Center may consider reducing the interest rate should the analysis required under paragraph VIII. A. 4, “Hub/Program Center Processing,” justify the need. In no case, however, may the rate be less than one percent.
- B. There shall be a due on sale, mortgage prepayment, mortgage expiration, or mortgage insurance termination clause.
- C. The term:
  - 1. Where the underlying mortgage has matured and the owner has not obtained new financing, the term of the note may not exceed 20 years.
  - 2. If there is a refinancing, the term of the Operating Assistance note shall not exceed the term of the new mortgage.
- D. The principal balance, if any, remaining unpaid, plus accrued interest, shall be due and payable at the earliest of the occurrence of the following events:
  - 1. Following written notice to cure a failure to make monthly payments of principal and interest on the note, or
  - 2. Upon prepayment, maturity, or foreclosure of the refinanced first mortgage note (if applicable), or
  - 3. Upon the sale, transfer, assignment, or any other disposition of the project.
- E. Payments:
  - 1. There shall be level annuity monthly payments that fully amortize the Flexible Subsidy Loan over the specified period.
  - 2. If the Flexible Subsidy Loan is secured by a surplus cash note, the note shall indicate the specific percentage of surplus cash that will be due within 60 days of the required filing of the Certified Annual Financial Statement.
  - 3. The owner will be required to apply 15 percent of the owner maximum annual distribution towards the outstanding Flexible Subsidy Loan. The payment will be cumulative in the event there is no surplus cash available when the calculation is made.

4. The owner will be required to pay 15 percent of any LIHTC developer fee or LIHTC developer deferred fee towards the outstanding Flexible Subsidy Loan.
- F. HUD reserves the right to sell the Flexible Subsidy Loan. If HUD sells the loan, the owner will be required to submit annual financial statements to the new holder of the loan in the same form as submitted to HUD.

## **VII. The Owner's Proposal**

Owner submissions must show that deferred repayment of the Operating Assistance Flexible Subsidy Loan is necessary to achieve long-term project preservation. The Hub/Program Center should not process any deferral requests unless it has received a complete owner's package, as detailed below. In making a request, the owner shall provide the following information:

- A. A copy of the current year's budget, most recent interim financial statement, and the last three fiscal years of audited financial statements. The owner must use these statements to develop and provide projections for 10 years post closing of the Flexible Subsidy Loan, estimating the amount of cash flow that will be available to fund monthly payments on the Flexible Subsidy Loan. Projections should detail trending assumptions and any changes in operations that result in deviations from historical results.
- B. A Sources and Uses Statement for the transaction and a Pro-forma Operating Statement demonstrating that:
  1. All funds received in conjunction with the Flex Repayment Event will be used for project purposes. In cases involving a refinancing, equity take-outs and other fees are prohibited. In cases involving a sale, the purchase price may not exceed the existing project debt, except in connection with the sale of a project that will use Low- Income Housing Tax Credits (LIHTC), in which the difference between the amount of the existing project debt and the appraised value of the property on the sale date may be secured by a seller note that is subordinate to all other notes and liens on the real estate and that requires repayment only to the extent of available surplus cash.
  2. In cases involving the use of Low-Income Housing Tax Credits, allowed project expenses may include only those usual and customary fees and expenses for operating a tax credit project, including payment of the equity syndicator's asset management fees; state allocating agency's compliance and asset monitoring fees; mandatory interest payments of up to one percent due on subordinate debt provided by a governmental lender; and deferred developer's fees, plus interest accrued at the applicable federal rate, which may be deferred for no more than 12 years. The deferred developer's fee may be included as an operating budget line item but may only be paid from surplus cash. The project rents may not exceed market rents for comparable units in the area. At the end of the 12-year fee deferral period, the project rents must be reassessed, since the deferred fee with have been fully paid.

- C. Evidence of the attempts made to secure loans or grants to repay the Flexible Subsidy obligation, if resources are insufficient to repay the Flexible Subsidy Loan (in whole or in part) at the Flex Prepayment Event.
- D. A written statement agreeing to comply with each of the programmatic requirements listed above in Section V.
- E. A description of how the property is providing and will continue to provide needed affordable housing and any additional information needed to support the deferral request.

### **VIII. Hub/Program Center Processing**

- A. The Hub/Program Center will review and analyze the owner's proposal and request additional information from the owner, as necessary. The Hub/Program Center is authorized to reject or accept any deferral proposal. This determination to reject or accept a deferral request shall be based on the following analysis:
  - 1. Determine that the owner's submission is complete and meets the Threshold Requirements under Section IV and Programmatic Requirements under Section V. Record findings and any variances in the owner's submission on the Checklist shown in Appendix 1. If the submission is incomplete, return it to the owner immediately.
  - 2. Analyze Management and Occupancy Reviews and REAC Inspection Reports. Determine that the owner and management agent have the capability to resolve current and future problems. Analyze the owner's discussion of problems, if any, and steps planned to resolve them. The analysis must include a review of HUD files and systems to validate the problems.
  - 3. Review the Sources and Uses statement to make sure all funds received in conjunction with the Flex Repayment Event will be used for project purposes.
    - a) In cases involving a refinancing, equity take-outs and other fees (e.g., accountant, consultant, and attorney) are prohibited. The Hub/Program Center must pay close attention to any developer fees that are listed in the Sources and Uses Statement.
    - b) In cases involving a sale, the purchase price may not exceed the existing project debt, except in connection with the sale of a project that will use Low-Income Housing Tax Credits in which the difference between the amount of the existing project debt and the appraised value of the property on the sale date may be secured by a seller note that is subordinate to all other notes and liens on the real estate and that requires repayment only to the extent of available surplus cash.

- c) In cases involving the use of Low-Income Housing Tax Credits, allowed project expenses may include only those usual and customary fees and expenses for operating a tax credit project, including payment of the equity syndicator's asset management fees; state allocating agency's compliance and asset monitoring fees; mandatory interest payments of up to one percent due on subordinate debt provided by a governmental lender; and deferred developer's fees, plus interest accrued at the applicable federal rate, which may be deferred for no more than 12 years. The deferred developer's fee may be included as an operating budget line item but may only be paid from surplus cash. The project rents may not exceed market rents for comparable units in the area. At the end of the 12-year fee deferral period, the project rents must be reassessed, since the deferred fee will have been fully paid.
4. Determine the base year (first full year after closing of the refinancing) NOI that will be available to amortize the Flexible Subsidy Loan. The Hub/Program Center must review the project's income, expenses, vacancy rate, and NOI submitted by the owner and make adjustments where necessary. The following subjects must be discussed in the Program Center's submission to the Hub:
- a) Income and Expenses. Besides rent, other sources of income and adjustments must be analyzed. This may include, but is not limited to, parking, commercial space, laundry, tenant charges and historical bad debt. The impact of the proposed use restriction must also be examined. The Hub/Program Center should select three comparable projects in the Online Project Integrated Information Suite (OPIIS) and determine if the income and expense estimates provided by the owner fall within five percent of comparable projects. In the event of variations in excess of five percent, the Hub/Program Center must provide the owner with their analysis and the owner must provide a justification.
  - b) Economic vacancy rate: This is verified by reviewing the current rent roll and comparing these rents with the approved rent schedule. Note: The economic vacancy rate takes into consideration the concessions and rent reductions that the owner may have used to increase the physical occupancy of the project. Because of concessions like these, the project may have a reasonable level of units occupied, but the income may be insufficient to pay all expenses and debt service. The economic vacancy should show a flat to decreasing trend over the last six months.

B. In addition to analyzing the owner's proposal, the Hub/Program Center shall also:

1. Prepare the appropriate Flexible Subsidy Use Agreement.<sup>3</sup>

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<sup>3</sup> The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0577. In accordance with the Paperwork Reduction Act, HUD may not conduct or

- a) The Use Agreement will extend project affordability to 20 years from the date of the original mortgage maturity or the date of full repayment of the fully-amortized Flexible Subsidy Loan, whichever is longer.
  - b) The Use Agreement will also provide for continued HUD oversight and monitoring.
  - c) The Use Agreement must be recorded prior in time to any new first mortgage financing.
2. Obtain concurrence of Field Counsel before submitting recommendation to the Hub Director.
  3. Complete the Flexible Subsidy Repayment Checklist shown in Appendix 1.
- C. If the Program Center finds that the owner’s proposal meets the requirements given above in Sections IV, V, and VI, the Program Center Director will send an approval recommendation (with Field Counsel’s concurrence) to the Hub Director, along with a Waiver Request Package. The Waiver Request Package will consist of the following materials:
1. A “Waiver Request” memorandum from the Hub Director to the Assistant Secretary for Housing-FHA Commissioner. This memorandum will give background information on the project, summarize and discuss the owner’s proposal, state any additional requirements that the owner must meet, and discuss the pros and cons of the proposal. See Appendix 2 for an Example of a Waiver Request memorandum.
  2. A “Waiver Approval” memorandum from the Assistant Secretary for Housing-FHA Commissioner to the Hub Director, granting the waiver. See Appendix 3 for an Example of a Waiver Approval memorandum.
  3. The owner’s proposal.
  4. The completed Checklist.
- D. If the Hub Director agrees with the Program Center Director’s recommendation, the Hub Director shall sign the “Waiver Request” memorandum and forward the Waiver Request Package to Headquarters, Director, Office of Asset Management.

## **IX. Office of Housing Responsibilities**

The Director, Office of Asset Management, will review and concur in the Waiver Request Package based on the recommendation of the Hub Director.

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sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.



After concurring, the Director, Office of Asset Management, shall forward the Waiver Request Package to the following Headquarters staff for concurrence before submitting it to the Assistant Secretary for Housing-FHA Commissioner for approval of the waiver:

- Associate Deputy Assistant Secretary for Multifamily Housing Programs
- Deputy Assistant Secretary for Multifamily Housing Programs, and
- Associate General Deputy Assistant Secretary for Housing

#### **X. Pre-Closing Processing Responsibilities**

After receipt of the waiver, the Hub/Program Center shall:

A. Process legal documents:

1. Provide Field Counsel with a copy of the waiver approval and request a review of the required closing documents to ensure they are consistent with the requirements for deferral of repayment of a Flexible Subsidy Loan and are in conformance with local law.
2. Amend the HAP Contract to include language that requires submission of Annual Financial Statements and adherence to REAC physical inspection standards.
3. In the case of a conventional lender, request the owner to sign the Flexible Subsidy Use Agreement and the Amendment to the Financial Assistance Contract and return them at least one week prior to closing. After receipt of the documents, execute and return them to the title company.

**Note:** The monthly payment amount and loan balance cannot be filled in until the Fort Worth Accounting Office has received the wire transfer from the owner and applied the funds to the indebtedness.

4. In the case of a HUD-insured closing, provide a memorandum to the Operations Director, requesting that the Flexible Subsidy Use Agreement and the Amendment to the Financial Assistance Contract be included in the documents that are signed at closing. Note in the memorandum that the Use Agreement must be recorded in a first position.

B. At least 10 working days prior to closing, provide the Fort Worth Accounting Office with a copy of the waiver approval and:

1. Provide closing date.
2. Ask when the first payment will be due based on the estimated closing date.
3. Request a consolidation of multiple Flexible Subsidy Loans, if applicable.
4. State the amount of down payment that will be sent on the day of closing. (Refer to C. 2. 3. and 4. below.)
5. Verify the outstanding balance (prior to application of any required down payment) on the Flexible Subsidy Loan.
6. Request preparation of a new amortization schedule.

7. Obtain wire instructions for the title company's transfer of money.
- C. At least 10 working days prior to closing, review an updated Sources and Uses Statement from the owner.
1. Verify existing reserve balances with the lender.
  2. Look for changes to the Source and Uses Statement subsequent to the original submission which would impact the amount the owner has to pay down on the Flexible Subsidy Loan. For example, there may be net proceeds or changes in underwriting that would require additional escrow amounts not approved by HUD.
  3. Review existing reserve balances to determine what amount should be paid down on the Flexible Subsidy Loan. Typically, the entire General Operating Reserve would be used to pay down the loan as well as Reserve for Replacement balances over \$1,000 per unit and residual receipts balances.
  4. Reach agreement with the owner on the amount that will be paid down on the Flexible Subsidy Loan based on Headquarters' approval and review of the Sources and Uses document.

## **XI. Day of Closing**

The Hub/Program Center shall:

- A. Verify that the owner has wire transferred the required down payment.
- B. Execute the required documents.

## **XII. Post-Closing Requirements**

Within 30 days of closing, the Hub/Program Center shall:

- A. Confirm that the Fort Worth Accounting Office received the wire transfer.
- B. Send the Fort Worth Accounting Office the Use Agreement, the amended Financial Assistance contract, and the fully-executed Flexible Subsidy note with the revised terms of the loan, including the monthly payment amount and the loan balance. Upon receipt of the note, Fort Worth will generate an amortization schedule and send it to the Hub/Program Center.

**Note:** If the monthly payment amount shown on the amortization schedule does not agree with the payment in the note, the Fort Worth Office will contact the Hub/Program Center regarding amendment of the note.

- C. Send a copy of documents to the owner with a cover letter explaining the repayment terms. Include instructions to make monthly payments for the deferred loan on-line to [www.pay.gov](http://www.pay.gov).

- D. Record the Use Agreement and send a copy to Headquarters, Office of Asset Management, Attention: Business Relationships and Special Initiatives Division.
- E. Update iRems to reflect the Amended Flexible Subsidy Loan and use restrictions.

**XIII. Servicing Requirements**

- A. As long as the Flexible Subsidy Loan is held by HUD, closely examine the owner's Annual Financial Statement to ensure all income and expenses plus reserves and accounts payable are properly accounted for and that surplus cash is accurate. An example of an improper practice would be running the cost of a replacement reserve item through expenses, rather than requesting a withdrawal from the reserve. Expenses should also be closely examined to ensure no expenses have been incurred related to the Flexible Subsidy Loan. All accounting, legal, and consultant fees must be paid for by the owner and not out of project accounts.
- B. Continue to service the property to ensure compliance with the Use Agreement.
- C. Check with the Fort Worth Accounting Office periodically to ensure the owner is making the required payments on the loan.

If you have questions, please contact your Desk Officer in the Office of Asset Management.

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David H. Stevens  
Assistant Secretary for Housing –  
Federal Housing Commissioner