CHAPTER 2. LOAN ADMINISTRATION: RESPONSIBILITIES OF MORTGAGE SERVICING

Section 1. Introduction

2-1. A successful mortgage loan servicing department is one that achieves both corporate policy objectives and departmental goals. Basic corporate objectives include maximizing interest revenue and reducing risk. Reducing risk includes assuring that the property is maintained in good physical condition for the use and enjoyment of its tenants. More specific loan servicing department goals are to minimize servicing costs and to build goodwill with customers and the public. Another goal is to provide an effective training program for its personnel.

2-2. Maximizing revenue. Loan servicing staff must maintain careful and thorough supervision over loans they service and must impress the borrower with the importance of repaying the loan according to the provisions of the agreement. Borrowers' prompt and full payment of their monthly obligations allows the lender to recoup its initial investment on schedule; it also allows the lender to maximize the yield on its investment by having the funds available for re investment in new mortgages. There are two basic principles for maximizing interest revenue: 1) obtain the revenue as quickly as possible; 2) reinvest the income. When servicing loans for other lenders or investors, float is another method of maximizing revenue. Float is a result of the unequal timing between the receipt of monthly payments from mortgagors and the servicer's disbursement of these payments to the mortgage investor and to other parties. The cash involved in the float can often be held in short term investments for the benefit of the servicer. Obviously, the earlier the funds are collected, the greater the revenue from the' float.

2-3. Reducing risk. Even with the protection of HUD's mortgage insurance, a lender is vulnerable to possible loss on every mortgage loan it makes or buys. Loss can result from property deterioration, from unpaid tax assessments or insurance bills, and from delinquent payments. Loss also can occur through deductions from mortgage insurance claims. To reduce the risk of incurring these types of losses, the loan servicing staff should keep accurate records and adhere unfailingly to the details of a follow-up system.

a. For illustration, the person responsible for monitoring real estate taxes must keep track of the property taxes assessed and paid on each mortgaged property. Though the lender holds a first lien on the property, an unpaid real estate tax usually creates a prior lien on the property. If the tax bill remains unpaid for a specified period, the taxing authority can force a sale of the property. The proceeds of a sale will be used to pay the real estate taxes, and the lender might receive nothing applicable to the mortgage debt. While this is important to the mortgagee and the mortgagor when unsubsidized projects are involved, it is of paramount importance to HUD and the tenants if the project is subsidized. All four parties risk the loss of assisted housing in the event of such a tax sale.

b. Mortgagees also reduce risk by making certain that each mortgaged property has insurance against loss because of fire, wind, explosion, other hazards, and sometimes floods. Unrepaired damage might reduce the value of the mortgaged property to less than the mortgage loan balance. If adequate insurance is in force, the mortgagor can repair the project promptly and the value of the project will remain stable.

2-4. Minimizing costs of servicing. Operating profitably is a goal of every servicing department. Servicing personnel help reduce expenses by doing their jobs efficiently. Cooperation with other departments, such as accounting and data processing, also increases efficiency. The cost of servicing each mortgage loan includes salaries, physical inspections of properties, postage, computer facilities, telephone, floor space, and supplies. Many of these costs increase when loans become delinquent. A program of preventive servicing designed to keep loans current can help control the variable costs.

Section 2. Fiduciary Responsibilities

2-5. FIDUCIARY: The term is derived from Roman law and means (as a noun) a person holding the character of a trustee in respect to the trust and confidence involved in the trust and the scrupulous good faith and candor that the trust requires. One acts in a "fiduciary capacity," or receives money or contracts a debt in a "fiduciary capacity," when the business that he transacts or the money or property that he handles is not his own or for his own benefit but for the benefit of another person as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part. Out of a fiduciary relation, the law raises the rule that neither party may exert influence or pressure upon the other, take selfish advantage of this trust, or deal with the subject matter of the trust in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith and with the full knowledge and consent of that other. Business shrewdness, hard bargaining and astuteness to take advantage of the forgetfulness or negligence of another are totally prohibited between persons standing in a fiduciary relationship to one another.

2-6. Servicing mortgagees have three sets of fiduciary relationships.

a. First, and perhaps most important, is their fiduciary responsibility to mortgagors. The covenants of the mortgage instrument itself establish this relationship. One must notice the implications contained in the title, "Deed of

Trust." In this capacity the servicer must, among other tasks:

1. Collect funds from the mortgagor and apply those funds properly.

2. Analyze escrow accounts accurately.

3. Pay taxes on time to maximize available discounts.

4. Invest certain escrowed funds (Residual Receipts, Reserve Funds for Replacements) if requested by the mortgagor to do so.

5. Provide information to the mortgagor, e.g., annual statements of account, on time.

b. Second, the servicer is responsible to the investing mortgagee. The servicing contract between the two parties customarily establishes the relationship. The servicer usually:

1. Remits funds to the investor as they become due.

2. Protects the physical security by maintaining adequate hazard and other forms of insurance.

3. Protects the physical security by conducting thorough physical inspections of the project each year.

4. Maintains a low default ratio through strong collection efforts and by analyzing mortgagors' annual financial statements and monthly accounting reports when the latter are applicable.

5. Provides periodic reports on the status of loans it is servicing for the investor.

c. Third, the servicing mortgagee is responsible to HUD:

1. It must pay the Mortgage Insurance Premium (MIP) when due.

2. It must inform HUD of changes in its address, of mortgage insurance terminations, and of many of other items.

3. It must furnish HUD a copy of its annual Physical Inspection Report of the project in a format acceptable to HUD.

4. It must keep adequate property insurance in force.

5. It must have and use a Quality Control Plan for servicing mortgages.

6. It must not permit prepayment of, or voluntary termination of mortgage insurance on, mortgages on certain low-income projects without HUD's prior approval.

7. It should make every effort to provide HUD Field Offices and HUD Headquarters with a delinquency alert for mortgagors that have not paid their payments by the

fifteenth of the month.

2-7. SERVICING MORTGAGEES ARE PIVOTAL MEMBERS OF THE HOUSING TEAM! Servicers make enormous contributions which, when combined with the efforts of their borrowers, investors, and HUD, help preserve and protect the housing stock of this nation.

a. Their obligations to other agencies or parties, such as FDIC, may exist but these obligations are beyond the scope of this handbook.

b. The remaining sections of this Chapter contain specific servicing tasks and procedures that, if followed, should enable the satisfactory and profitable fulfillment of servicing responsibilities.

Section 3. Quality Control Plans and Credit Management

2-8. The Department of Housing and Urban Development requires all mortgagees servicing insured multifamily project mortgages to have a Quality Control Plan. On December 26, 1989, HUD issued Mortgagee Letter 89-32 entitled, "Quality Control Plan for Approved Mortgagees (see Appendix 7)." The provisions of this Mortgagee Letter are incorporated in the requirements of this handbook and will not be restated here. But the primary objectives of the quality control plan are to assure:

a. Compliance with HUD requirements.

b. That the mortgagee's employees know and follow its policies and procedures.

c. That the mortgagee revises its procedures as changes in HUD's requirements occur.

d. That employees of the mortgagee are accountable for performance failures and errors.

e. That the mortgagee identifies deficiencies in servicing, takes prompt and effective corrective action, and so informs its affected employees.

f. That procedures exist for expanding the scope of quality control reviews where the mortgagee identifies fraudulent activity or patterns of deficiencies.

2-9. Many instructions contained in Mortgagee Letter 89-32 are germane to servicing only home mortgages: many are used for multifamily servicing as well. This Mortgagee Letter should be construed to be included in the servicing requirements of this Chapter 2. Mortgagees servicing insured multifamily project mortgages must develop Quality Control Plans that include servicing these mortgages.

2-10. There are a number of principles that belong to an effective program for sound credit management, which is essentially a strategy for controlling account servicing, portfolio management, and delinquent debt collection. Servicing and investing mortgagees should give consideration to these concepts as they develop and implement their own internal policies and procedures.

a. Billing Practices. Mortgagees should ensure that there is routine invoicing of payments due. Usually this invoicing will be done monthly.

Invoices should include the date the payment is due and the date it will be considered late (i.e., grace period).

b. HUD's regulations at 24 CFR 207.14(c) permit mortgages to provide for the collection by the mortgagee of a late charge, not to exceed two (2) cents for each dollar of each payment to interest or principal more than fifteen (15) days in arrears, to cover the expense involved in handling delinquent payments. Late charges, if assessed, shall be separately charged to and collected from the mortgagor and shall not be deducted from any aggregate monthly payment or from any other funds of the mortgagor received or held by the mortgagee for any other purpose.

c. Documentation. Insured loan files should contain adequate and current information reflecting payment history. They shall include all occurrences of delinquencies and defaults. They shall include any loan actions that result in payment deferrals or rescheduling. Mortgagees should record the time and outcome of each contact with the mortgagor; they should include notification of delinquent status, requests for repayment, and steps taken for delinquent debt collection. Mortgagees are urged to keep in a secure place accurate documentation and records pertaining to HUD authorized releases from the Reserve Fund for Replacements and the Residual Receipts Fund. Failure to do so could adversely affect the amount HUD pays in mortgage insurance if a claim is made.

d. Credit Reporting Agencies. Mortgagees should have agreements with credit reporting agencies for the transfer, storage, protection; and dissemination of account information. All commercial accounts (current and delinquent) should be reported to commercial credit bureaus. Commercial accounts are not covered by the Privacy Act. Mortgagees need adequate accounting systems to identify and to refer debts to a credit bureau.

e. Delinquent debt collection. Mortgagees should establish procedures for following up on past due accounts. These procedures might provide for as many as three progressively stronger written demands for payment issued at not more than 20-day intervals. Lenders should adopt more aggressive

collection techniques if the debtor's response to the initial notice provides evidence that additional notices will not be effective.

f. Risk Assessments and Loan Loss Estimates. To have a full and accurate picture of the financial condition of each portfolio, mortgagees should assess the probability that existing loans might not be repaid. Lenders ought to estimate the losses that could be incurred. This recommendation applies to holding mortgagees and to servicing mortgagees. Lenders are advised to establish procedures for assessing the risk inherent in each loan in their portfolios.
(REMINDER: HUD Regulations state, at 24 CFR 207.262, "Neither the mortgagee nor the mortgagor shall have any vested or other right in the General Insurance Fund.")

1. A risk rating can be assigned to each loan. The rating could reflect changes in the borrower's financial position and changes in the status of col lateral or security. The system of classification maintained by the Comptroller of the Currency is one recommended rating system.

2. HUD requires project owners to submit audited financial statements each year to the mortgagee and to HUD. HUD analyzes these financial statements to assess compliance with program requirements, to evaluate the financial strength of the mortgagor, to consider requests for rent increases, and for many other purposes. Lenders need not and should not review these financial statements from HUD's perspective. Lenders should conduct their examination to the extent necessary to classify asset values and make risk assessments. Servicing mortgagees should write the mortgagor, with a copy of the request to the Loan Management Branch of the HUD Field office, and request the audited financial statement if the mortgagor does not submit the audited financial statement when due.

3. HUD regulations require annual physical inspections of

projects by mortgagees and submission of the physical inspection reports to HUD and the mortgagor. These inspections must be of a sufficiently high quality to permit an accurate evaluation of the condition of the property by the mortgagee and by HUD. This annual inspection, combined with any other inspections made by the mortgagee, would provide part of the basis for evaluating and classifying a loan. The mortgagee, upon the effective date of this handbook, shall set up a schedule of physical inspections so that at least ten (10) months but no more than twelve (12) months lapse between the required annual inspections of any particular project.

Section 4. Routine Servicing

2-11. There are eight basic functions in servicing multifamily mortgages insured by HUD:

1. Servicing loan payments.
2. Servicing escrow accounts.
3. Servicing real estate taxes.
4. Servicing insurance.
5. Servicing contract changes.
6. Servicing HUD requirements.
7. Servicing delinquent loans.
8. Making mortgage insurance claims.

This Section 4 contains procedures for the first five topics. Sections 5, 6, and 7 of this chapter 2 address the remaining three topics.

2-12. Servicing loan payments. When the loan closes and is finally endorsed for mortgage insurance, servicing usually becomes the responsibility of the commercial loan servicing department. Loan administration staff should immediately inform the mortgagor exactly what is expected of it. The servicer should do this with a separate, written instruction sheet. The mortgagee must tell the mortgagor clearly what the monthly payments are, that payments are the mortgagor's responsibility, and that they are due on the first of the month until the loan is paid in full.

a. Mortgagees should be especially careful of the first payments. If these payments are not in on the first of the month, mortgagees should have a follow up procedure to obtain payments promptly. Mortgagees must consider, based on their Risk Analyses, how they will follow up on payments that are not received. Mortgagees should have a written plan available for their employees to follow and for HUD to review when requested. Mortgagees should consider relationships between mortgagors and management agents when the latter are involved. Perhaps a direct telephone call from the mortgagee to a project's management agent would prove to be the best method of communication.

b. The mortgagee should be polite but firm when discovering why the payment did not arrive on the first.

1. Was it mailed to the correct address?
2. When was it mailed?

3. Is it in the possession of the mortgagee, perhaps in a mail room, but not in the loan administration department? If so, what internal changes should be made so that inappropriate contact with the mortgagor is avoided?
4. Was it sent to but not processed by a lock-box?
5. Who is at fault, the mortgagor or the mortgagee?

c. If the mortgagee has the payment by the first of the month but has not posted it by the second, the mortgagee has a problem that needs to be solved. But if the problem lies with the borrower, the best time to correct it is in the earliest days of amortization.

d. Projects are often managed for mortgagors by managing agents. If the late payment is not the fault of the mortgagee, the mortgagee should call the agent first. The mortgagee should inform the agent that the owner will be called if a second call is needed; this would enable the owner to deal with the managing agent. The mortgagee should impress on both the agent and the owner the importance of the regard for the mortgage obligation, and let both know, politely but firmly, that the mortgagee will not put up with late payments. The "grace" period is only a courtesy. Payments are due on the first.

e. Payments are applied as set forth in the mortgage and Regulatory Agreement, normally:

1. Mortgage Insurance Premium (MIP) escrow.
2. Ground rents.
3. Taxes.
4. Special assessments.
5. Water rates.
6. Property insurance premiums.
7. Interest on the note.
8. Amortization of principal.
9. Reserve Fund for Replacements.
10. Other reserves required by HUD.

f. The mortgagee must segregate escrow funds and deposit such funds in a special account with a financial institution whose accounts are insured by the FDIC or NCUA. Funds held in the escrow accounts may be held in accounts exceeding $100,000 per banking institution under the following conditions:

1. Mortgagees must determine that the banking institution has a rating consistent at all times with current minimally acceptable ratings as established and published by Government National Mortgage Association (GNMA)

2. Mortgagees must monitor the banking ratings no less than on a quarterly basis and change institutions when necessary. The mortgagee must document the ratings of institutions where escrow funds are deposited and maintain the documentation in the administrative record for three years, including the current year.

3. If the mortgagee does not perform the required quarterly review at banking institutions where there are deposits in excess of $100,000 and does not maintain the funds in a banking institution with a rating consistent with current minimally acceptable ratings as established and published by GNMA, and the institution fails, the mortgagee is held responsible for replacing the funds. In addition, the mortgagee shall be subject to sanctions. In the event the mortgagee fails to replace the lost funds, HUD will seek all available remedies, including those against the mortgagee, to recover whatever funds are lost as a result of the failed institution.

g. A mortgage is considered current if the mortgagor remits enough money to cover items 1 through 8 in paragraph 2-12.e. above; failure to cover items 9 or 10 is a "covenant" or "technical" default under the terms of the Regulatory Agreement and is not a default under the mortgage. Note: Failure to pay a Late Charge is never a default. When the remittance of insufficient funds causes a technical default, the mortgagee should notify the Loan Management Branch Chief of the HUD Field Office by letter that the full payment was not made. The mortgagee should send this letter by the fifteenth day of the month during which the payment was not made.

h. If items 9 or 10 in paragraph 2-12 above remain uncovered from the previous month, the mortgagee should apply the current month's payment first to items 1 through 8 due for the current month,

then apply any remaining sums first to items 9 and 10 from the prior month and then to items 9 and 10 due for the current month. The mortgagee should keep the HUD Field Office Loan Management Branch notified of the status of the Loan so HUD staff can act and assist the mortgagee in its debt collection efforts. HUD is very concerned whenever full payments are not made by project owners and HUD needs to be informed about fiscal and technical defaults as soon as they occur.

2-13. Servicing Escrow Accounts: General Considerations. To ensure that funds will be available to pay taxes and insurance premiums, mortgagees must establish escrow accounts for the monthly payments that mortgagors must make.

a. Each month the mortgagee must collect from the mortgagor an amount which the mortgagee estimates will be sufficient to enable it to pay all escrow obligations prior to delinquency. These obligations are:

1. Mortgage Insurance Premiums.
2. Taxes, special assessments, ground rents.
3. Hazard insurance premiums.
4. Flood insurance premiums where required.

b. The mortgage instrument provides the authority for the mortgagee to accumulate sufficient escrow funds with which to pay the mortgagor's tax and insurance bills thirty days prior to the time the bills become delinquent. For example, tax bills are frequently due each year on January 1st. Here the mortgagee should have sufficient funds on hand as of December 1st (assuming timely remittance and application of the mortgage payment due December 1st) to pay the tax bill on January 1st. HUD does not object to other accrual periods occasioned by variations in tax jurisdictions, particularly where the mortgagor may realize a savings. For instance, substantial discounts might be available if the taxes due January 1st were paid on November 1st. Here the mortgagee would need sufficient funds on hand as of October 1st to pay the discounted tax assessment by November 1st. The mortgagee should discuss these kinds of possibilities with the mortgagor and make every effort to accommodate any reasonable request

made by the mortgagor to obtain available discounts.

c. Escrow funds shall be used for only the purpose for which they were collected. They are subject to audit and examination by HUD. Under no circumstances shall a lender use escrow funds for delinquent payments, late charges, or any other charges.

d. The restriction on escrow accounts is not intended to apply to each escrow item as a separate entity but to the entire escrow account. It is not necessary, for example, that funds collected for the payment of taxes be used only for the payment of taxes, although the mortgagee might so structure its accounts for bookkeeping purposes only. The intent of the requirement is that the aggregate of funds collected for escrow items be sufficient to pay bills which are properly to be paid from the escrow account.

e. Mortgagees may not charge interest for escrow deficiencies. A deficiency exists only when there are insufficient funds to pay a tendered bill or an untendered bill thirty (30) days prior to the due date, whichever comes first.

f. HUD regulations neither forbid nor require that escrow accounts bear interest. HUD does not permit mortgagees to invest monies deposited in escrow accounts unless the net income is paid or credited to the account of the mortgagor. Net income is the earnings remaining after the expenses that are directly related to the investment of the monies and that are directly related to the servicing of the interest-bearing escrow accounts have been retained by the mortgagee.

g. Expenses may be calculated as they are incurred on an individual account basis or as they are incurred and applied against income derived from the mortgagee's entire portfolio of insured mortgages. Mortgagees, of course; need to examine their expenses regularly in a continuing effort to keep them at the lowest possible level.

h. If the income from the investment less actual administrative costs results in a net loss, such loss may not be passed on to the mortgagor.

Mortgagees' charges may not exceed actual costs for administering the interest-bearing account.

2-14. Escrow Analysis. Escrow analysis is a periodic review of escrow receipts and disbursements to decide whether the monthly deposits will provide adequate amounts to satisfy tax, insurance, and other obligations when they become due. Escrow requirements are first estimated by the time a loan is closed and the amount of the monthly payment is established.

a. It is the mortgagee's responsibility to make escrow disbursements before bills become delinquent. Mortgagees must establish controls to ensure that bills payable from the escrow fund or the information needed to pay such bills is obtained on a timely basis. Penalties for late payments for items payable from the escrow account must not be charged to the mortgagor unless it can be shown that the penalty was the direct result of the mortgagor's error or omission. Early payment of a bill to take advantage of a discount should be made whenever it is to the mortgagor's benefit if sufficient escrow funds are available.

b. Not later than the end of the second loan year, the mortgagee shall establish a system for the periodic analysis of the escrow account. The mortgagee must make this analysis at least once annually and adjust the escrow payment to provide a sufficient accumulation of escrow funds to make anticipated disbursements during the following year.

c. The mortgagee must give the mortgagor at least sixty days notice of adjustments in monthly payments together with an adequate explanation of the reasons for any change.

d. The mortgagee shall refund to or collect from the mortgagor any escrow surplus or shortage as required by the security instrument. The mortgage typically contains a clause to credit an escrow surplus to subsequent monthly payments of escrows. The mortgagee may refund an excess to the mortgagor by a disbursement to the project's operating account; if it should choose to do so, it is strictly as a concession to the mortgagor and not as a right of or an expectation by the mortgagor. Good judgement might dictate that when the mortgagee's physical inspection indicates a need for immediate action and when excess escrow funds exist, the

mortgagee could release such excess funds to the mortgagor's operating account as needed repairs are made.

e. The mortgagee shall make its estimate of escrow requirements based on the best information available about probable payments that will be required from the account in the coming year. If it uses actual disbursements during the preceding year as the basis for making this estimate, the resulting estimate is allowed to deviate from those disbursements by as much as ten per cent if the previous year's expenses indicated that a percentage of up to ten per cent for the second previous year was necessary. The mortgagee must keep in mind that the purpose of escrow analysis Is to assure that adequate escrow balances are available at the time of billing and that excessive escrows do not adversely affect the mortgagor's cash flow.

f. The mortgagee may carry over to the next period an escrow amount no greater than one-sixth in excess of the actual current requirements. The mortgagee must not hold larger amounts unless expressly requested by the mortgagor and unless the need for a larger amount is adequately documented by the mortgagor.

g. The mortgagee should examine its own history of escrow surpluses or shortages to see if changes in its methods of analysis are needed.

2-15. Servicing taxes. The amount of the annual real estate tax bill must be estimated from the best available source. When a loan is secured by an existing property, the amount of taxes can usually be estimated by multiplying the assessed valuation by the current tax rates. When a loan is secured by newly constructed improvements, the previous year's assessed valuation would have been on a different basis; using that basis would not be appropriate. In such a case, assessments of several similar properties, adjusted for variances, may provide a reasonably accurate estimate of valuation for establishing the required monthly tax deposit for the first year or two of amortization.

2-16. Servicing insurance. HUD Regulations, at 24 CFR 207.10 and

207.260, are
explicit about insurance requirements. The mortgagee must obtain insurance coverage if the mortgagor does not. HUD may terminate the mortgage insurance contract if insurance is not maintained.

Mortgagees must notify HUD within thirty (30) days of the cancellation of insurance or of the refusal of the insurance company to renew the insurance. Mortgagors must carry fire and extended coverage insurance in an amount that meets the coinsurance requirements of the insurer and is at least equal to 80 percent of the actual cash value of the project's insurable improvements and equipment. Mortgagee Letters 83-24 and 86-8 are in Appendix 7; these Letters provide additional information and requirements about insurance and are incorporated in this paragraph by reference.

2-17. Servicing contract changes. The mortgage and the note contain the essential terms of the contract of indebtedness. The borrower, the secured property, and the loan terms are the three basic elements considered in mortgage loan underwriting. If the loan applicant has a reliable income and a sound credit record, and if the property is a worthwhile investment, the institutional underwriter adjusts the loan terms (within limits) to balance several factors. These factors are (1) the borrower's budget and financial resources; (2) the property's useful life, and (3) the lender's need for a safe, profitable investment.

a. A later change in any one of the elements or factors can disrupt the balance. In certain cases, as when a small part of the project must be released from the mortgage security for a public purpose, the lender has little choice. Such taking can be without the approval of the mortgagee or HUD. The responsibility remains with the mortgagee to keep informed about such condemnation proceedings to assure that claim for adequate compensation is instituted.

b. When the mortgagor desires to negotiate a partial release of security, the mortgagor must first obtain the written consent of the mortgagee. The mortgagee may require conditions and restrictions for its approval. HUD also must consider and approve, conditionally approve, or disapprove requests for partial releases of mortgage security. HUD frequently requires some prepayment of principal as a condition for approving a negotiated partial release of security.

c. When the mortgagor wants to sell its project, it must submit to HUD a formal Application for Transfer of Physical Assets (Form HUD 92266). Normally the mortgagee signs the Application. If

the mortgagee refuses to execute the Application, it must write HUD and state the reason for refusing to sign the form.

In two instances HUD will not accept a transfer application which has not been signed by the mortgagee:

1. Where the mortgage has not been finally endorsed for mortgage insurance, and

2. Where the proposal to transfer involves the creation of a lien against the property. In this second case mortgagees agree to waive certain rights, so lenders should use due diligence in examining such proposals.

Section 5. Servicing HUD Requirements

2-18. In exchange for the benefits of HUD's mortgage insurance protection, mortgagees agree to adhere to a number of requirements. First and foremost, mortgagees agree to become HUD-approved mortgagees. The procedures for becoming an approved mortgagee are contained in HUD Handbook 4060.1, Mortgagee Approval Handbook, and will not be restated here. It is sufficient to remind mortgagees that annual reporting to HUD is necessary as a condition for continuing approval.

2-19. Annual Physical Inspections. HUD Regulations, at 24 CFR 207.260(a), state:

"Annual inspection of property by mortgagee. As long as the mortgage is insured by the Commissioner, the mortgagee shall ascertain the general physical condition of the mortgaged property in each calendar year commencing with the calendar year following completion of the project. The mortgagee shall furnish the Commissioner and the mortgagor with a copy of its inspection report, which shall contain the mortgagee's recommendations for any necessary action." The inspection and reporting requirement is included in the Mortgagees Certificate signed by mortgagees. The inspection and reporting requirements were restated in Mortgagee Letter 88-22, issued July 11, 1988. Key points of this Mortgagee Letter are restated here. Where differences between the Mortgagee Letter and this handbook exist, this handbook prevails. There should be no misunderstanding of the importance HUD attaches to annual physical inspections by mortgagees.

2-20. Inspection Requirements. Lenders must inspect each property at least once each year. The inspection must be of sufficiently high quality to permit an accurate evaluation of the condition of the property by the mortgagee and by HUD. Mortgagees must schedule inspections so that at least ten (10) months but no more than twelve (12) months lapse between their physical inspections of any particular project. Lenders should contact the local HUD Field Office when developing an inspection schedule. The Field Office can provide information about required repairs and its own on-site visits to projects. Lenders should ask the project's owner or management agent to be present during the inspection. Immediately before inspecting a project, the inspector should ask the Loan Management Branch staff of the HUD Field Office if there are any known and outstanding maintenance problems. HUD Field Offices may not

not impose more stringent inspection requirements upon mortgagees than the requirements established in this handbook or in HUD Handbook 4350.1.

a. Before inspecting a project the mortgagee should review its files:

   1. Past inspections -- results and follow-up actions.

   2. Property insurance loss drafts (inspection of repairs needed). NOTE: Mortgagees are not permitted to charge mortgagors for any inspections, including inspections made in connection with property insurance loss drafts.

   3. Withdrawals from the Reserve Fund for Replacements or the Residual Receipts accounts for repairs (inspection of repairs needed or made).

b. During the inspection the mortgagee's inspector should:

   1. Walk through the project's grounds, common areas, office, and maintenance work areas.

   2. Determine if any maintenance or repairs required by the mortgagee or by HUD have been acceptably completed or are underway and progressing on schedule.

   3. Select at least two units at random from the list of vacancies. If time and resources permit, select two additional vacant units: One should be a unit that has not been cleaned or repaired after move-out; another should be a unit which is ready for occupancy. Experience has shown that inspecting a unit that has been off-line for a longer period of time than one which was recently vacated and not cleaned and repaired can reveal more information about turnover and make-ready procedures than might otherwise be discovered.

   4. Select several occupied units at random and inspect those units.

   5. Ask the owner or management representative about causes of maintenance problems,

maintenance procedures, and major repairs, both recently completed and anticipated.

6. Assess the condition of the items listed in Part B of Form HUD 9822, Physical Inspection Report. The Form HUD 9822 can be obtained from local HUD Field Offices.

7. Summarize the observations and conclusions reached during the inspection for the owner or management representative at the end of the inspection.

c. Reporting Requirements. The servicing mortgagee must send the HUD Field Office and the mortgagor a written report of the inspection within thirty (30) days following the inspection. If a managing agent is managing the project, the mortgagee also should send the agent a copy of the report. The report must be prepared on Form HUD 9822 (OMB Approval No. 2502-0369) or a Field Office approved computer facsimile of the form. The mortgagee is not required to complete the "cost estimates" portion of the form; it should write a narrative summary describing the general condition of the property and if possible provide pictures that typify the results of the inspection. Although not specifically required by HUD, servicing mortgagees should ask their holding mortgagees if they would like copies of the physical inspection reports. When reasons exist for not meeting the 30-day deadline, e.g., when an inspection report is returned to a contractor for corrections, mortgagees are encouraged to notify the HUD Field Office of the reasons for the delay before expiration of the deadline.

1. In the "Comments" Section (Part E) of the HUD 9822, the mortgagee should cross-reference particular line items in Parts B, C, or D of the Report and discuss at least the following topics:

(a) Any maintenance needs noted in Part B of the Report. If maintenance is urgently needed, the mortgagee should suggest a target completion date.

(b) Any problems noted in Part C of the Report.

(c) The lender's opinion about reasons for any "Below Average" or "Unsatisfactory" ratings given in Part D of the Report.

2. The cover letter sending the report to the owner must require the owner to:

(a) Return to the mortgagee a written statement within thirty (30) days about how and when the owner will correct all deficiencies noted in the report.

(b) Send the HUD Field Office a copy of the owner's response.

d. Follow-up Action. If the mortgagor has not responded within thirty days or if the response is not satisfactory, it may be necessary for the mortgagee to call the mortgagor. The mortgagee should confirm the results of conversations in writing, with a copy to the HUD Field Office. If the mortgagor remains uncooperative, the mortgagee should call the Asset Management Branch Chief of the HUD Field Office and ask for any assistance HUD can give.

2-21. HUD's requirements regarding holding and investing monies in the Reserve Funds for Replacements and Residual Receipts are described below:

a. The revised Section 8 regulations require owners of projects subject to those regulations to invest monies held in the Reserve Fund for Replacements and in the Residual Receipts Account.

b. The Residual Receipts of all projects with HUD-insured mortgages must be invested with interest accruing from the investments credited to the Residual Receipts Account.

c. Consistent with program regulations and the Regulatory Agreement, the Reserve Fund for Replacements must be maintained by the mortgagee. Investment options for the Reserve Fund for Replacement should be determined jointly by the mortgagor and mortgagee. The Regulatory Agreement requires, "such fund, whether in the form of a cash deposit, or invested in obligations of, or fully guaranteed by the United States of America, shall at all times be under the control of the mortgagee." This paragraph suspends this provision by authorizing the mortgagee to invest funds in excess of $100,000

in U. S. government-backed securities and to hold funds in excess of $100,000 in institutions under the control of, and whose deposits are insured by, the Federal Deposit Insurance Corporation, National Credit Union Association, or other U. S. government insurance corporations under the following conditions:

1. Mortgagees must determine that the institution has a rating consistent at all times with current minimally acceptable ratings as established and published by Government National Mortgage Association (GNMA).

2. Mortgagees must monitor the institution's ratings no less than on a quarterly basis, and change institutions when necessary. The mortgagee must document the ratings of the institutions where the funds are deposited and maintained the documentation in the administrative record for three years, including the current year.

3. If the mortgagee does not perform the required quarterly review of the institutions where there are deposits in excess of $100,000 and does not maintain the funds in an

institution with a rating consistent with current minimally acceptable ratings as established and published by GNMA, and the institution fails, the mortgagee is held responsible for replacing any lost funds. In addition, the mortgagee shall be subject to sanctions. In the event the mortgagee fails to replace the lost funds, HUD will seek all available remedies to recover whatever funds are lost as a result of the failed institution.

d. The above language is not deemed a modification of the Regulatory Agreement. Therefore, HUD reserves the right to invoke this Regulatory Agreement provision and make it operational in the future through notice or handbook change, if it is determined that such a policy is necessary or desirable.

2-22. Investing Money in Residual Receipts Funds for Certain Section 8 Projects. Investment of Residual Receipts is required for certain projects receiving Section 8 assistance.

a. The revised Section 8 regulations apply to all owners of older Section 8 projects where the owners voluntarily opted to be bound by those regulations.

b. The revised Section 8 regulations also apply to projects for which:

1. Agreements to Enter Into Housing Assistance Payments Contracts (AHAPs) were executed on or after November 5, 1979 for New Construction projects. 24 CFR subpart 880.601(e) provides, "Use of project funds. (1) Project funds must be used for the benefit of the project, to make required deposits to the replacement reserve in accordance with ' 880.602 and to provide distributions to the owner as provided in '880.205. Any remaining project funds must be deposited with the mortgagee or other HUD-approved depository in an interest-bearing residual receipts account. Withdrawals from this account will be made only for project purposes and with the approval of HUD. (2) Partially-assisted projects are exempt from the provisions of this section. (3) In the case of HUD-insured projects, the provisions of this paragraph will apply instead of the otherwise applicable mortgage insurance provisions."

2. Agreements to Enter Into Housing Assistance Payments Contracts (AHAPs) were executed on or after February 20, 1980, for Substantial Rehabilitation projects. 24 CFR subpart 881.601(e) provides, "Use of project funds. (1) Project funds must be used for the benefit of the project, to make required deposits to the replacement reserve in accordance with ' 881.602 and to provide distributions to the owner as provided in '881.205. Any remaining project funds must be deposited with the mortgagee or other HUD-approved depository in an

interest-bearing residual receipts account. Withdrawals from this account will be made only for project purposes and with the approval of HUD. (2) Partially-assisted projects are exempt from the provisions of this section. (3) In the case of HUD-insured projects, the provisions of this paragraph will

apply instead of the otherwise applicable mortgage insurance provisions."

2-23. Investing Residual Receipts of All Other Projects. The Residual Receipts of all other projects should be invested, with interest accruing from the investments credited to the Residual Receipts account. Interest may be transferred from the Residual Receipts accounts of these projects to the operating funds of these projects without HUD's written instructions.

2-24. Investing Money in the Reserve Fund for Replacements for Certain Section 8 Projects. Investment of the Replacement Reserve funds is required for certain projects receiving Section 8 assistance.

a. The revised Section 8 regulations apply to all owners of older Section 8 projects where the owners voluntarily opted to be bound by those regulations.

b. The revised Section 8 regulations apply to projects for which:

1. Agreements to Enter Into Housing Assistance Payments Contracts (AHAPs) were executed on or after November 5, 1979, for New Construction projects. 24 CFR subpart 880.602 (a) provides, "A replacement reserve must be established and maintained in an interest-bearing account to aid in funding extraordinary maintenance and repair and replacement items." Subpart 880.602(a) (3) provides, "All earnings including interest on the reserve must be added to the reserve." Subpart 880.602(b) provides, "Partially-assisted projects are exempt from the provisions of this section."

2. Agreements to enter Into Housing Assistance Payments Contracts (AHAPs) were executed on or after February 20, 1980, for Substantial Rehabilitation projects. 24 CFR subpart 881.602(a) provides, "A replacement reserve must be established and maintained in an interest-bearing account to aid in funding extraordinary maintenance and repair and replacement of capital items." Subpart 881.602 (a) (3) provides, "All earnings including interest on the reserve must be added to the reserve." Subpart 881.602(b)

provides, "Partially-assisted projects are exempt from the provisions of this section."

2-25. Investing Reserve Funds for Replacements of All Other Projects. The Reserve Fund for Replacements of all other projects should be invested, with interest accruing from the investments initially credited to the Reserve Fund account. Interest may be transferred from the Reserve Fund accounts of these projects to the operating accounts of these projects periodically at the mortgagor's request and without specific written instructions from HUD.

2-26. Servicing mortgagees need to remember their fiduciary responsibilities to mortgagors when establishing a fee structure for investing Residual Receipts and Replacement Reserve funds. They should recover only their actual administrative costs, which should never exceed 25 per cent of the interest earned from the investment. If these costs are excessive a mortgagee should make every effort to control or reduce its costs. Mortgagees are to collect their investment charges, if any are made, separately and apart from other collections from the mortgagor. These charges may be collected by a separate billing to the mortgagor or by a separate Letter Agreement with the mortgagor. Only for those Section 8 projects required by HUD's regulations to have the reserve funds invested may agreed upon charges be collected from interest earned by the investments.

NOTE: All monthly payments are due on the first of the month. If the monthly payment is received more than 15 days after the due date, more than once during a calendar year, the mortgagee may deduct Late Charges from the interest accruing to either the Reserve for Replacement Fund or Residual Receipts Account without the express written consent of HUD or the mortgagor for any subsequent late monthly payments during the calendar year.

2-27. Liquidity. The mortgagor, not the mortgagee, is responsible for deciding the liquidity requirements of funds held in the Reserve Fund for Replacements and the Residual Receipts Account. However, the mortgagor should maintain some portion of its reserves in the form of very liquid assets. As a guideline and depending upon the specific project, $50/unit, or three or four months' required deposits to the Reserve Fund may be enough to meet minimum liquidity requirements. For those projects that maintain both a Reserve Fund for Replacements

account and a Residual Receipts account, the money held in these two accounts may be combined jointly to purchase a single investment if and only if all three of the following conditions are met:

a. The mortgagor requests that action in writing.

b. Separate bookkeeping entries are established in the books of the mortgagor and the books of the mortgagee to reflect the correct pro-rata accruals of interest to the respective accounts.

c. The mortgagor agrees in writing to reimburse both accounts for the loss of any principal amount which may be suffered by premature liquidation of the investment. This reimbursement may be effected by deducting from the amount to be released to the mortgagor an amount sufficient to make up the loss.

2-28. Timeliness. Mortgagees should make investments in a timely manner. Normally this should be within five to ten business days after receipt of the mortgagor's request unless extenuating circumstances exist. The mortgagee is to credit the mortgagor's account with interest as it is earned in accordance with Generally Accepted Accounting Principles. HUD strongly encourages, and in some cases requires, that interest earned from the investment of reserve accounts be kept in those accounts. However, except for certain projects assisted under Section 8 (where interest must remain in the Reserve Account), interest may be returned to the mortgagor's operating account if the project is in an acceptable physical condition. disbursements of interest to the operating account of the project should be made at least semi-annually unless the mortgagor requests less frequent payments.

2-29. Minimum amounts of investments depend on the type of investment selected by the mortgagor. For example, if some funds are held in a passbook savings account, a reasonable minimum would be the amount remitted each month for deposit into the Reserve Fund. Good business judgment should prevail if minimum investment amounts are set by a mortgagee.

2-30. Reporting to HUD, General, HUD Handbook 4060.1, Mortgagee Approval Handbook, describes in detail various reports which different categories of mortgagees must make. These requirements are not

restated in this Chapter 2, but mortgagees are reminded of the existence of these requirements.

2-31. Mortgagees must keep HUD informed of certain changes that may occur over the life of the mortgage. They also provide other information upon specific requests. Mortgagees normally become aware of three events before HUD does and they must inform HUD when these happen. These three events are: 1) change in mortgagee(s); 2) termination of mortgage insurance; and, 3) change in loan status. Although these reporting requirements and their instructions are generally known, they are restated here for convenient reference. Samples of forms that are used are in the Appendix.

a. Mortgage Record Change, Form HUD-92080. Mortgagees should use this form for insured loans only, not for commitment assignments. Detailed instructions for submission of this form are contained in HUD Handbook 4110.2, The Mortgagee's Guide Home Mortgage Fiscal Instructions. Whenever there is a change of servicer or a sale of a HUD-insured mortgage, HUD should be advised within fifteen calendar days of the action in order to amend its records so that future premium notices and correspondence can be directed properly. The mailing address is on the form. HUD would consider it a courtesy if a copy of this form is sent to the HUD Field Office which has jurisdiction over the project; this would help maintain good communications between HUD and the mortgagees involved. In the alternative, a telephone call to the Loan Management Branch of the Field Office would have the same effect as mailing the courtesy copy to the Field Office.

1. Sale of Mortgage. It is the Seller's responsibility to submit this form (HUD 92080). Boxes 1, 2, 3, and 5 through 14 must be completed by the Seller. Box 15 should be signed by an authorized official of the purchasing mortgagee. Signatures in Boxes 14 and 15 are official notice to HUD that the insured loan has been sold in accordance with HUD regulations.

2. Change of Servicer. Boxes 1, 2, 3, 5, 7, 8, 10, 12, and 15 must be completed.

3. Changes of addresses of the holding or the servicing mortgagee. Although use of this form is not specifically mandated for reporting address changes, mortgagees would probably find that using this form to report these changes is the most convenient means to notify HUD of address changes. If address changes are not reported quickly, mortgagees run the risk of, for instance, having billings for Mortgage Insurance Premiums sent to a former address; the delays which might then result could cause surcharges to the mortgagee which would otherwise be unnecessary.

b. Request for Termination of Multifamily Mortgage Insurance Form HUD-9807. This form is executed by the servicing and investing mortgagees when a mortgage is to be prepaid in full; the mortgagor as well must execute it when voluntary termination of mortgage insurance is being requested. Mortgages insured under certain Sections of the Act may not be prepaid in full, nor may their mortgage insurance be terminated, without HUD's written approval. The Form HUD-9807 (Appendix 3) itself should be reviewed for exact instructions and restrictions, but these Sections are shown below for convenient reference:

Act Section	Special Conditions Requiring Approval
207/223(f)	All projects with commitments to insure issued after 10/8/80, unless five years have elapsed since endorsement (or 20 years in the case of mortgages purchased by GNMA under section 305 of the National Housing Act)
221(d)(3)MR	Almost all projects, except certain projects which are owned by limited dividend owners and

	do not receive project-based Section 8 or Rent Supplement assistance (Consult OGC's Multifamily Mortgage Division for further guidance.)*
221(d)(5)	All [often called "221(d)(3) BMIR"]

Act Section	Special Conditions Requiring Approval
231	All Non-Profit Projects
232	All Non-Profit Projects
236	All
Title XI	All

*Note: To reduce the possibility of mortgages being prepaid without HUD's consent where such consent may be required, Form HUD-9807 requires a written request for HUD approval for certain categories of projects where the necessity for such approval requires OGC's determination.

c. Multifamily Default Status Report, Form HUD-92426. Mortgagees use this form to report any one of five changes in the status of the loan. These are: 1) initial default; 2) update on default status; 3) reinstatement; 4) election to assign or acquire; and 5) withdrawal of prior election. More instructions for using this form are contained in Section 6 of this Chapter 2.

Section 6. Servicing Delinquent Accounts

2-32. General. No one will argue with the statement, "The best way to service a delinquent loan is to keep it current." For instance, revenue and expense statements of the mortgagor, either monthly or yearly, are important. Mortgagees should always review these carefully and compare them with previous statements. Future delinquencies may be foreseen and perhaps prevented by analysis of these statements. If the mortgagor is uncooperative in providing these statements, the mortgagee should contact the Loan Management Branch of the HUD Field Office for assistance.

a. If some item is out of line, the mortgagee should question the item; it should get an explanation that makes sense. Neglecting or "milking" a project usually shows up first on an operating statement.

b. Some operating statements, when compared to previous ones, show a downward trend in gross income. This trend is counter to general, long-term economic trends, it usually indicates something is wrong, and it should be checked out. Sometimes the amounts spent for repairs and replacements or for other necessary items show a decrease. Sometimes occupancy levels show a decrease, or accounts receivable and bad debt write-offs show an increase. Has there been a change in management?

c. The project and its income are the investing mortgagee's (and HUD's) security. Where indicated, the mortgagee should arrange for a meeting with the project's owner and perhaps with its managing agent; it should discuss the problems with the staff of the Loan Management Branch of the local HUD Field Office. They will be grateful for the opportunity to help servicing mortgagees prevent delinquent accounts.

d. The servicing mortgagee and HUD can and often do "team up" and act in concert to impress upon recalcitrant mortgagors the importance of the mortgage obligations.

2-33. Many loans become delinquent and then go into default after a long history of slow payments. Sometimes servicing mortgagees simply allow a slow paying mortgagor to continue with slow payments, adopting the

undesirable attitude of, "Slow pay is better than no pay." Sometimes a new servicing mortgagee acquires servicing responsibility for a loan which has had a long history of poor payments. Occasionally a loan that has had an excellent payment history suddenly becomes delinquent and then goes into default. Whatever may be the case, the servicing mortgagee's responsibility and immediate task is to restore the loan to a routine servicing status as quickly as possible.

2-34. Delinquent accounts cost more to service because they are more staff-intensive (requiring more time to arrange and have meetings, visit the project, write letters, make telephone calls, etc.), and because they deprive the mortgagee of float. Both the revenue and the expenses of the servicing mortgagee are adversely affected by delinquent loans.

2-35. The mortgagee needs to determine the causes of delinquency or default There are many conditions that, either singly or in combination, may cause delinquencies and defaults. The mortgagee should ask the mortgagor promptly to remedy the conditions under its immediate control. Some of these causes are:

a. Inexperienced, ineffective, or absentee ownership or management where the project is owner-managed and where the owner lacks the expertise or interest necessary to operate the project as it should be operated.

b. Project abandoned or bankruptcy petition filed.

c. Improper financial operations, such as payments to owners, loans to owners or other projects, or excessive costs, particularly where identity-of-interest vendors are involved.

d. Deliberate disregard for mortgage obligations, uncooperative mortgagor, or uninterested ownership. This is one of the common reasons for chronic delinquency and some mortgagors intentionally take advantage of the "grace period" to use the float for their own benefit.

e. Mortgagor has limited financial resources. There may not be sufficient working capital to make the mortgage payment that is due on the first of the month until the rents due on the first of the same month are collected,

deposited, and rent checks have cleared. Or the owner may be unwilling or unable to advance cash to the project for its continued operations. This is another major cause of chronic delinquencies.

f. Mismanagement or ineffective management.

g. Expenses (operating, taxes, insurance) have increased while rents have not. Break-even or negative cash flow.

h. Misjudgment of or change in rental market. Project lacks the unit mix (size and type of units) to compete; generally soft rental market because of, say, home buying or the new construction of other rental properties; rental rates too high even where supported by essential operating expenses.

i. Functional obsolescence. Project is not competitive with other rental communities in the market because of lack of facilities and amenities.

j. Generally depressed economy.

2-36. The servicing mortgagee acts promptly to learn the reasons for the delinquency or the default. Few chronic delinquencies and fewer defaults will cure themselves. Prompt and accurate identification of the causes of a problem loan or an impending default is imperative if the mortgagee is going to help the mortgagor. For clues to the reasons for the problem, the mortgagee should review the mortgagor's financial statements before calling the mortgagor. For example, if these statements show adequate income and working capital, the problem might be a recalcitrant owner or managing agent. on the other hand, decreasing occupancy levels might point towards economic, marketing, or design problems. Discussions with the owner and the agent will be more productive if the lender first reviews the financial statements.

2-37. Mortgagees notify HUD of the delinquency or the default. HUD issued Mortgagee Letter 83-1 on January 12, 1983, and asked mortgagees to volunteer to alert HUD about mortgage payments that were not received by the fifteenth of the month. HUD and lenders have common financial interests in projects with insured loans. HUD and lenders can be very effective when working as a team to help mortgagors develop

solutions to problems of delinquencies and defaults. Mortgagees must inform HUD about a default that continues for thirty (30) days by completing Form HUD 92426, "Multifamily Default Status Report," within
* thirty (30) days thereafter even if the default is cured before the date by which HUD must be notified. When a default that continued for thirty days is cured before the deadline for notifying HUD of the default, the mortgagee must provide HUD with both a Notice of Default and a Notice of Reinstatement using Form HUD 92426. Failure to do so could jeopardize a subsequent mortgage insurance claim. Table 2 below provides default * dates and deadlines associated with default events. However, notwithstanding this maximum 30-day timeframe, HUD would deeply appreciate being informed of a default as soon as possible (at least within ten days) after it occurs. The Form HUD 92426 is used to report defaults, reinstatements, and elections to assign a mortgage or acquire title to a property.

Table 2. Default Dates and Related Deadlines

Unpaid Instlmnt. Due on	Must Be Be Paid	Mortgagee Eligible for Insurance On	Notify HUD by H.O.b.	Make Election to Assign Mortgage
Jan 1	Jan 31	Feb 1	Mar 2	Mar 17
Feb 1	Mar 3	Mar 4	Apr 2	Apr 17
Mar 1	Mar 31	Apr 1	Apr 30	May 15
Apr 1	May 1	May 2	May 31	June 15
May 1	May 31	June 1	June 30	July 15
June1	July 1	July 2	July 31	Aug 15
July1	July 31	Aug 1	Aug 30	Sept 14
Aug 1	Aug 31	Sept 1	Sept 30	Oct 15
Sept1	Oct 1	Oct 2	Oct 31	Nov 15
Oct 1	Oct 31	Nov 1	Nov 30	Dec 15
Nov 1	Dec 1	Dec 2	Dec 31	Jan 15
Dec 1	Dec 31	Jan 1	Jan 30	Feb 14

1. These dates assume 28 days in February; adjust for leap years.
2. For deadlines falling on Sat., Sun., or federal holiday, use next business day.

2-38.The investor also should be notified promptly if a serious problem becomes apparent. The need to notify the investor depends on the requirements of the investor and on such factors as the amount of the loan in relation to the security.

2-39.Occasional delinquencies are common, but delinquencies can be tolerated only under genuine distress conditions. Highly personalized attention is needed on a loan which is in arrears for as long as five to seven days. Lenders need to find out the reasons for delinquencies as part of a strategy for preventive servicing. By paying close attention to occasional delinquencies, lenders can help establish closer communications among the members of the housing team and prevent future defaults. Late charges normally are not very effective in enforcing collections; if late charges are assessed they help the mortgagee recover the increased costs associated with servicing delinquent accounts. If late charges are assessed they generally must be collected from the mortgagor separately, i.e. , late charges may not be deducted from regular mortgage payments, escrows, other impound accounts, Reserve Funds for Replacements, or Residual Receipts accounts. However, if the regularly scheduled monthly payment is received more than fifteen days after the due date more than once during a calendar year, the mortgagee may deduct Late Charges from the interest accruing to either the Reserve Fund for Replacements or the Residual Receipts account without the express written consent of HUD or the mortgagor for the second and subsequent late monthly payments during the calendar year.

2-40. Chronic delinquencies. If servicing mortgagees reduce the number of chronically delinquent loans they will make more money. Solutions depend on the causes of the delinquencies. Lenders have tools available to use when curing these kinds of problems.

a. For instance, if the mortgagor is deliberately withholding mortgage payments the lender could remind the mortgagor that the lender has the power to grant or to deny certain concessions. These include direct refunding of excess sums held in impound accounts, consent to partial releases of security, and consent to transfers of physical assets. Other concessions include consent to Mortgage Modification Agreements or Provisional Workout Arrangements.

b. Lenders also could remind mortgagors who are chronically delinquent that the loan could "accidentally" slip into default, thereby jeopardizing the mortgagor's continued ownership of the project. Lenders could inform chronically delinquent mortgagors that immediate foreclosure would be recommended to HUD if assignment of the mortgage should become necessary.

c. If lenders routinely discuss problems of chronic delinquencies with the Loan Management Branch staff of local HUD Field Offices serious problems could often be averted.

2-41.Occasional defaults occur. A default constitutes a much more serious breach of the mortgage than does a delinquency. Lenders must take immediate action in the event of a default besides merely reporting it to HUD. Defaults jeopardize the continued ownership of the project by the mortgagor, and lenders should remind mortgagors of this fact. Lenders should have already been in touch with mortgagors during the period of delinquency before the default stage is reached. A default should not be a surprise; lenders can anticipate it.

a. At the occurrence of the initial default event, a servicing mortgagee should be able to estimate the likelihood of reinstatement. It should have learned the reasons for the default. It should have worked with the mortgagor to develop plans to cure the delinquency. These plans should be the basis for a plan to reinstate the loan. The mortgagee should have discussed the problems and possible solutions with the HUD Field Office. An action plan for reinstatement or assignment of the mortgage should be in place.

b. The servicing mortgagee also should inform the holding mortgagee of the issues as the servicer develops a plan for actions to be taken. The investing mortgagee has the ultimate responsibility and authority for the decision to assign the mortgage to HUD.

c. The servicing mortgagee is reminded to notify HUD of the default as described in Paragraph 2-33 of this handbook, using Form HUD 92426.

d. The election decision must be made by the investing mortgagee within seventy five (75) days from the date of default unless

the mortgagee requests an extension of this deadline. This decision should be a fully informed decision in which the servicing mortgagee and HUD have discussed the issues and the likelihood of reinstatement with the investor.

e. Requests for extensions of the deadline for electing to assign a mortgage or to acquire and tender title to a project must be in writing. These requests are sent to the local HUD Office by the servicing mortgagee.

   1. The extension request should set forth the justification for the requested extension.

   2. Extensions will be deemed justified if there is satisfactory protection of income and if there is a prospect for reinstating the mortgage.

   3. In most cases of the initial default, an extension should be requested to afford the mortgagee and HUD additional time to: (a) Investigate the default further; (b) Negotiate with the mortgagor; (c) Allow the mortgagor enough time to cure the default under a reinstatement plan approved by the mortgagee and by HUD.

f. If the mortgagee fails to elect to assign the mortgage or obtain an extension from HUD within the prescribed time limits it will be faced with the choice of either accepting a curtailment of interest on the claim because of the late election or basing its claim on a subsequent default (thus delaying the default date for purposes of calculating the claim).

2-42.Reinstatement. There are a number of tools which may be available to cure a default when the causes of the default have been determined. The mortgagee, the mortgagor, and HUD need to explore these solutions together. The Loan Management Branch Chief of the local HUD Field Office needs to be involved in discussions involving the development of a reinstatement plan. After the mortgagee, the mortgagor, and HUD have agreed to a reinstatement plan, the mortgagee and the mortgagor need to agree to this plan in writing. Many of these remedies can be used in combination with one another. Nearly all require the fullest

cooperation of the three team members. Some solutions require more time to develop and use than others. Reinstatement proposals could include several of the following actions:

a. Infusion of additional cash by the mortgagor as either an equity contribution or in the form of an unsecured loan.

b. Releases from the Reserve Fund for Replacements or from the Residual Receipts Account.

c. Suspending deposits to the Reserve Fund for Replacements.

d. Requests for deferment of payments to principal.

e. Adjustments to rental rates, upward or downward.

f. Tax abatement.

g. A change in management or in ownership.

h. An Operating Loss Loan.

i. A Supplemental Loan for Capital Improvements.

j. Additional project-based subsidy in the form of Section 8 assistance.

k. Flexible Subsidy Assistance for certain projects.

l. Special Forbearance Relief and Special Insurance Benefits for projects insured under Sections 220, 221 and 236.

m. Partial payments of claim for rental or cooperative housing projects that are or potentially could serve as low- and moderate-income housing resources.

n. Bond refunding for bond-financed projects.

2-43.Chronic defaults constitute a very dangerous threat to the housing team. The mortgagor stands to lose the project. The servicing mortgagee may expect to lose future servicing revenue. The investing mortgagee usually risks losing some of its investment. HUD's insurance funds are

subject to a loss. The costs of servicing chronically defaulted loans are much greater for the servicer and HUD.

a. Servicers should try to have a meeting with chronically defaulting mortgagors. This meeting should be usually held in the mortgagee's office. The mortgagee should explore thoroughly the problems leading to a continuing default. The servicing mortgagee needs to decide whether to recommend to continue holding the mortgage in default or to assign the mortgage to HUD. The servicer makes this recommendation to the investor.

b. If a mortgagee decides to work with a mortgagor, it must request from HUD any necessary extensions of the assignment election deadline. Although there is no maximum number of extensions that HUD may approve, extensions shall be limited to the period necessary to accomplish the intended objectives. The Housing Management Division Director of the local HUD office is authorized to extend, in 30-day increments, the regulatory period within which the holding mortgagee must elect to acquire and tender title to the property or to assign a mortgage.

c. The Housing Management Division Director also is authorized to grant a one-time, six month extension of the regulatory period if the extension is to cover negotiation of a reinstatement plan; the mortgagee or HUD can make a reinstatement plan subject to cancellation upon failure of the mortgagor to perform.

2-44.If development of a workable reinstatement plan does not appear possible or practical and if it does not appear likely to the investing mortgagee that the loan will ultimately regain a current status, the holding mortgagee may choose to exercise its option to assign the mortgage or acquire and convey title to the property.

a. Under the contract of mortgage insurance, the mortgagee may elect to:

1. Assign the mortgage to HUD, in which event the claim generally will be reduced by one percent (1%) of the unpaid principal balance; or

2. Acquire and convey title to the property, in which event

settlement of the claim will include the unpaid principal balance as of the date of default.

b. HUD may ask the mortgagee to assign the mortgage to HUD in lieu of foreclosing on the property, in which case all or part of the one percent deduction is waived.

c. Unless the HUD Field Office approves an extension of time, the mortgagee must make its election within seventy five (75) days after the date of default. The mortgagee should use Form HUD 92426, Multifamily Default Status Report, but an "election letter" is acceptable.

* d. The date of default is the due date of the first unpaid payment when payments are applied in the order in which they come due. For example, if an owner did not make the payment due June 1 by July 1, the mortgage is in default as of June 1. If the payment is not made on or before July 1, the mortgagee's entitlement to receive insurance benefits vests on July 2 (the day following the expiration date of the 30-day grace period which begins after the payment due date). If the owner did not make the June 1 and July 1 payments but did make one monthly payment on August 15, the mortgagee could apply the payment received on August 15 to the June 1 payment if the mortgagee had not made its election to assign the mortgage to HUD.

1. In the preceding example, if the mortgagee applied the funds received on August 15 to the payment due June 1, July 1 would be the new default date for purposes of calculating insurance benefits. In this case the mortgagee must comply with all procedural and filing deadlines that apply to the new default date. In this example, the mortgagee must submit a notice of default using Form HUD-92426 no later than August 30 regarding the delinquent July 1 payment and must make the assignment election by September 14 unless an extension of this latter deadline is requested from and granted by HUD.

2. The Department encourages mortgagees to choose the option to allow a mortgagor to make up a payment that is past due in order to allow time to work with the mortgagor. However, mortgagees are advised to require either certified funds or a wire transfer of funds to guard against applying a check drawn on insufficient funds to cure a default of sixty or more days duration to guard against not meeting the 75-day deadline for the assignment election.

3. Using this same example, if the mortgagee applied a check received on August 15 to the payment due June 1 and if the check were not honored, the mortgagee would still be responsible for making its assignment decision and

election by AugUst 15 unless it received HUD's written extension of the deadline for making the election. Failure to make the assignment election by its deadline will impair mortgage insurance benefits.

e. For fully insured mortgages Form HUD-92426 must be submitted monthly until the mortgage has been reinstated or until an insurance claim has been filed.

f. Mortgagees should refer to the instructions on the Form HUD-92426 for additional information about filing requirements. Mortgagees should make certain that all dates and dollar amounts are correctly entered.

g. If the mortgagor cures the default prior to completion of foreclosure proceedings, mortgage insurance shall continue as if a default had not occurred provided the mortgagee gives written notice of reinstatement to HUD.

Section 7. Claims

2-45.Mortgagees notify HUD of Election and Withdrawal decisions by sending an original and one copy of Form HUD-92426, Multifamily Default Status Report (or an "election letter"), to HUD Headquarters, Office of Multifamily Housing Management. HUD will provide specific instructions for completing the claims process. These instructions may vary from time to time or the instructions may vary for mortgages insured under different Sections of the Act. By way of general information, a Fiscal Data Package for a fully insured mortgage will need to be prepared by the assigning mortgagee and submitted to HUD. This package of forms is in Appendix 5 as a "Sample" only; it includes the following:

a. "Instructions for Applications for Insurance Benefits," HUD-2741

b. "Mortgagee's Application for Insurance Benefits," HUD-2747

c. "Mortgagee's Application for Partial Settlement," HUD-2537

d. "Statement of Taxes," HUD-434

e. "Fiscal Data In Support of Claim for Insurance Benefits," HUD-2742

f. "Allocation of Mortgage Receipts and Disbursements," HUD-2744A

g. "Mortgagee's Report of Project Collections," HUD-2744B

h. "Mortgagee's Report of Project Disbursements," HUD-2744C

i. "Other Disbursements by Mortgagee," HUD-2744D

j. "Mortgagee's Report of Special Escrow," HUD-2744E

k. Payment Information Form (see Appendix 7, pages 25 & 26)

Note: Forms HUD-9250 for the three calendar years prior to the assignment plus those approved in the calendar year of assignment are to be submitted to HUD when mortgages are assigned to HUD as part of a

Default Election. Mortgagees also must be careful to keep on file and be prepared to submit records evidencing all of HUD's approvals of all releases from the Residual Receipts Account. Failure to evidence releases as stated may result in a reduction of insurance benefits.

2-46. Claims for Coinsured Mortgages (Reserved).