

## CHAPTER 1. INTRODUCTION TO COINSURED LOAN SERVICING

1-1. ORGANIZATION OF HANDBOOK. This Handbook sets forth HUD's requirements regarding owners' management, lenders' loan servicing and oversight and lenders' acquisition and disposition of projects whose mortgages are coinsured under the Section 223(f) program. This chapter discusses HUD's, the lender's and the owner's rights and responsibilities in very general terms. Chapters 2 through 7 provide an in-depth discussion of HUD's requirements on use of project funds, financial reporting, rent increases, lenders' monitoring of project operations and other recurring servicing activities. Chapters 8 through 11 offer an in-depth discussion of HUD requirements for servicing troubled projects (e.g., curing defaults or requesting insurance benefits) and handling special actions (e. g. transfers of ownership) that occur only occasionally over the life of a coinsured mortgage. This Handbook does not provide instructions or requirements regarding property management, mortgage banking or loan servicing practices. Project owners are expected to know and apply sound property management practices or to contract out these responsibilities to a qualified management agent. Lenders are expected to know and to employ prudent and aggressive loan servicing to protect their own and the Secretary's interest in the coinsured loans.

### Section 1. Overview of Relationships and Responsibilities

1-2. RELATIONSHIP BETWEEN HUD, THE LENDER AND THE PROJECT OWNER. As in all multifamily programs involving HUD mortgage insurance, owners of coinsured projects administer the day-to-day operation of their projects and lenders holding the coinsured mortgages collect mortgage payments and act as escrow agents who administer replacement reserves and impounds for property taxes, hazard insurance and mortgage insurance premiums (MIP). In contrast to programs offering full insurance, in the coinsurance program lenders also are responsible for monitoring owners' compliance with HUD requirements and processing owners' requests for rental increases, reserve withdrawals, and other actions for which HUD approval is traditionally required. Generally, HUD's involvement in coinsured projects will be limited to the instances discussed in Paragraphs 1-2.a. through 1-2.f.

- a. Processing Requests for Previous Participation Clearance. HUD regulations at 24 CFR Part 200, Subpart H require that individuals wishing to assume ownership or management of HUD-related projects submit information on their previous participating in HUD programs and obtain HUD's written approval to participate in additional projects. All requests for Previous Participating clearance must be made on Form HUD-2530, Previous Participation Certification, and must be approved by HUD. Form HUD-2530 is shown in Appendix 1. Authority to approve additional participation cannot be delegated to coinsuring lenders.

- b. Assisting Troubled Projects. HUD will not intervene in lender/owner relationships unless the parties' inability or unwillingness to reach an understanding appears likely to jeopardize the Secretary's interests. HUD will assist the owner or lender when either party requests such assistance and it appears that such assistance will produce constructive results and not adversely affect the rights or interests of the other party.
  - c. Approving Selected Servicing Actions. The lender must obtain HUD's written approval before implementing any of the actions listed in Exhibit 1-1. Procedures for requesting this approval are included in the chapters in which those actions are discussed.
  - d. Providing Advice and Guidance. While lenders should route all project specific inquiries through the Field Office having jurisdiction over the project, lenders should send all requests for interpretations of policy and regulations to HUD Headquarters, Attention: Office of Multifamily Housing Management.
  - e. Monitoring of Lender's Coinsurance Activities. The coinsurance regulations require that HUD periodically monitor the lender's coinsurance activities. To carry out this monitoring responsibility, HUD will: (1) review the annual reports that Section 3 of this:; Chapter requires the lender to submit; and (2) periodically visit the lender's offices and review both the servicing files of a sample of the lender's coinsured loans and the lender's compliance with the quality control requirements of HUD Handbook 4060.1, Mortgagee Approval Handbook.
  - f. Auditing Owner's and Lender's Books and Records. HUD regulations, the regulatory agreement and/or the Management Certification give HUD, HUD's Inspector General and the Comptroller General authority to audit all records related to the owner's operation of the project or the lender's servicing and oversight. Such audits will be conducted when necessary to protect HUD's interest or to evaluate the owner's or lender's performance.
- 1-3. SCOPE OF HUD REQUIREMENTS. HUD's requirements for the 223(f) coinsurance program are set forth in the 223(f) Coinsurance Regulations at 24 CFR Part 255, in this Handbook, in HUD Handbook 4566.1, Coinsurance for Mortgage Lenders-Section 223(f), and in the controlling documents listed below. Program participants should read all of these documents carefully and must comply with both their literal meaning and their spirit and intent.
- a. Mortgage and Mortgage Note. The mortgage is the document which pledges the property as security for the note HUD

endorsed for coinsurance. The mortgage note sets forth the amount the owner owes the lender and the manner in which the debt is to be satisfied. The note establishes the payment terms, conditions under which prepayments may be made, and the lender's rights in the event of default. As used in this Handbook, the terms "mortgage" and "mortgage note" apply also to deeds of trust and deed of trust notes, respectively.

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- b. Mortgagee's Certificate. The lender executes the Mortgagee's Certificate at the loan closing. In executing the Certificate, the lender identifies all fees and escrow deposits collected in conjunction with the mortgage transaction and agrees to collect, hold and administer the reserve for replacements and any required mortgage escrows in accordance with HUD's requirements. This Certificate is shown in Appendix 2.
  - c. Regulatory Agreement. The regulatory agreement lists the management and reporting requirements that HUD and the lender impose upon the owner in return for their insuring the mortgage. The regulatory agreement also specifies what actions the lender and/or HUD may take if the owner does not carry out its obligations under the regulatory agreement. The owner must adhere to the regulatory agreement so long as the mortgage insurance is in effect. A model form of regulatory agreement is shown in Appendix 3. A lender may expand the model regulatory agreement to regulate the owner in additional areas so long as such provisions do not conflict with HUD's requirements and HUD's Office of General Counsel approves the additional provisions. The regulatory agreement is a key document and all parties should read it carefully.
  - d. Management Certification. In executing the Management Certification, the management agent: (1) certifies that it understands, and will comply with, HUD requirements relating to the operation and management of the project; (2) acknowledges the lender's and HUD's right to cancel a management agreement; and (3) agrees that, if any provision of the management agreement conflicts with the lender's or HUD's rights or requirements, the lender's or HUD's position will prevail. Owner-managed projects must use the Management Certification shown in Appendix 4a. Projects managed by identity-of-interest or independent agents must use the Management Certification shown in Appendix 4b.
- 1-4. CHANGES IN LENDER'S PERSONNEL OR PROCEDURES. If the lender wishes to change the key personnel or operating procedures already approved by HUD, the lender must obtain HUD's approval before implementing such changes. Key personnel include the supervisor or lead person responsible for each of the following activities: loan servicing, management oversight, and acquisition, management and disposition of acquired projects. The lender should send requests for HUD approval of changes in

these personnel or procedures to:

Office of Multifamily Housing Management  
U. S. Department of Housing and Urban Development  
Washington, DC 20410

The lender does not need HUD's approval before delegating servicing activities to another HUD-approved mortgagee, as provided in Paragraph 1-5 below, or before employing a real estate broker to handle the disposition of a project the lender acquired after the owner defaulted.

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- 1-5. DELEGATION OF SERVICING ACTIVITIES. GNMA Handbook 5500.1, GNMA Mortgage Backed Securities Guide, requires lender/issuers to directly service mortgages that back GNMA securities. In all other instances, the lender may choose to service its coinsured loans or arrange for another entity to service the mortgages so long as the contract servicer is a FHA-approved mortgagee and the coinsuring lender retains its obligations under the regulations. HUD does not need to approve the servicing arrangement in advance. However, if HUD considers the servicer's performance to be unsatisfactory, HUD may require the lender to cancel the servicing arrangement.
- a. Notifying HUD. When a lender contracts out its servicing activities, the lender must notify HUD by completing and submitting Form HUD-92080, Mortgage Record Change. This form is shown in Appendix 5. Instructions for preparation and submission are printed on the form. Copies of Form HUD 92080 and any of the other HUD Forms cited in this Handbook may be obtained from either the local HUD Field Office or HUD Headquarters Publications Service Center, Room B-258.
  - b. Notifying the Project Owner. The coinsuring lender must promptly notify the owner of any change in servicers so that mortgage payments, financial statements and correspondence relating to the coinsured mortgage will be sent directly to the new servicer.
- 1-6. SALE OF COINSURED MORTGAGES. Lenders may assign coinsured loans if the following four conditions are met: (a) the assignee is a HUD-approved coinsuring lender; (b) the lender shows good cause for such assignment; (c) HUD finds that such assignment is for good cause and that there will be no disadvantage to FHA; and (d) HUD gives prior written approval for such assignment. In addition, if a mortgage backs GNMA securities, the lender must also obtain GNMA's approval before assigning the mortgage.
- a. Requesting HUD Approval to Sell. Requests for HUD approval to assign coinsured mortgages must be submitted to HUD Headquarters, attention Office of Multifamily Housing Management. The lender's request must explain how

condition (b) above is met. If a lender assigns a coinsured mortgage without obtaining HUD's approval, HUD may suspend or terminate the lender's status as a HUD-approved coinsuring lender.

- b. Notifying HUD Following the Sale. After assigning a coinsured mortgage, the selling lender must notify HUD using the Form HUD-92080 shown in Appendix 5. The selling lender must obtain the purchasing lender's signature on the Form. The selling lender will not be relieved of its obligation to pay mortgage insurance premiums until HUD has received a properly executed Form HUD-92080.

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- 1-7. REINSURANCE OF COINSURING LENDER'S RISK. The coinsurance regulations permit the coinsuring lender to purchase insurance coverage of either: (1) 50 percent of its coinsurance risk; or (2) 100 percent of its coinsurance risk or the maximum amount which State law permits the insurer to insure. Any reinsurance policy must name HUD as contingent beneficiary in the event that the lender's default results in HUD paying GNMA amounts the lender owes to holders of GNMA securities. Paragraphs 11-2.b. and 11-2.c. explain how the amount of reinsurance will affect the computation of any insurance benefits.
  - 1-8. HUD SANCTIONS AGAINST COINSURING LENDERS FOR NON-PERFORMANCE OR MISCONDUCT. The coinsurance regulations and 24 CFR Parts 24, 25 and 200 give HUD authority to impose sanctions against lenders who do not comply with HUD'S requirements. Sanctions include suspending or withdrawing the lender's status as a coinsuring lender or HUD-approved lender and restricting the lender's (or its principals') participation in HUD's programs. Sanctions will vary according to the nature and seriousness of the offense. HUD Handbook 4060.2, Mortgagee Review Board, HUD Handbook 4065.1, Previous Participation Handbook, and Chapter 11, Section 4 of this Handbook explain the administrative procedures for imposing such sanctions and how the sanctions will affect the lender's current and future activities. Some of the violations for which HUD may impose sanctions are listed below.
    - a. Failure to maintain the level of sound capital resources required by HUD. However, if a coinsurance loss temporarily reduces the lender's reserves below the level required by the coinsurance regulations, HUD will allow the lender a reasonable time, not to exceed six months, to restore its capital reserves to the required level.
    - b. Failure to discharge its responsibilities under any regulatory agreement or coinsurance contract or to perform loan servicing, management oversight or property disposition in accordance with the provisions of this Handbook.

- c. Payment by the lender of any kickback, fee or other consideration to any person who has already been compensated for services performed in connection with a coinsured mortgage transaction. The lender may pay for the actual performance of services rendered in conjunction with a coinsurance transaction when HUD has approved such payment in advance.
- d. Submission of a false, fraudulent or incomplete report to HUD or the incurring or any indebtedness to HUD for which no satisfactory repayment plan or agreement is in effect.
- e. Failure to pay any amount owed to a holder of securities guaranteed by GNMA and backed by a coinsured loan.
- f. Assigning a coinsured mortgage to an entity that is not a HUD-approved coinsuring lender.

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- g. Failure to notify HUD, and obtain HUD approval, of changes in staffing or procedures, as required by Paragraph 1-4 of this Handbook.
- h. Other reasons that HUD determines to be justified in accordance with 24 CFR Part 24 or by action of the Mortgage Review Board in accordance with 24 CFR Part 25.

## Section 2. Start-up Servicing

1-9. OVERVIEW OF SECTION. This Section discusses the following actions which the lender must take at or soon after endorsement of a coinsured loan. These actions include:

- a. setting up a servicing file;
- b. establishing any escrow accounts required by the mortgage;
- c. distributing the amortization schedule and payment instructions;
- d. monitoring the disposition of any special escrows established at loan closing; and
- e. following-up on any management improvement actions required as a condition of mortgage insurance.

1-10. ESTABLISH SERVICING DOCKET. Immediately after closing, the lender must set up the mortgage servicing file. The file must bear the FHA project number assigned at endorsement as well as the lender's loan number. Exhibit 1-2 provides suggestions for the contents and organization of the servicing file. The docket in Exhibit 1-2 actually consists of two files: a general servicing file with eight sections and a financial file in which to store the annual and monthly financial reports. While lenders may deviate from Exhibit 1-2's suggested organization, the file should be structured to facilitate both the lender's servicing activities and HUD's periodic audits. Copies of the controlling documents must be kept in the servicing file throughout the life of the loan.

Other written documents must be retained for at least three years.

1-11. ESTABLISH REQUIRED ESCROWS. At closing, the lender must establish an escrow account for property taxes, hazard insurance, MIP and any other items for which the mortgage requires monthly escrows (e.g., special assessments, ground rents, flood insurance, etc.). The lender must collect from the borrower an amount which, when combined with the monthly escrow deposits, will be enough to pay bills 30 days before they become due. In the case of the real estate tax escrow, it is extremely important that the lender use the most current tax rate and assessment data for the area in which the project is located. Escrows required by coinsured mortgages must be deposited in a special account or accounts which are insured by the Federal Deposit Insurance Corporation (FDIC), the Federal Savings and Loan Insurance Corporation (FSLIC) or the National Credit Union Administration (NCUA). The administration of required escrow accounts is described in greater detail in Chapter 2.

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1-12. DISTRIBUTE AMORTIZATION SCHEDULE AND PAYMENT INSTRUCTIONS. At or immediately following closing, the lender must provide the owner with an amortization schedule and instructions for making monthly payments. The amortization schedule must show amounts due monthly for principal, interest, MIP due HUD, and any insurance premiums due the lender.

1-13. ADMINISTER ANY SPECIAL ESCROWS REQUIRED AT CLOSING. The firm commitment or closing documents may require escrows in addition to those discussed in Paragraph 1-11. Special escrows are generally required when the final inspection shows repair items have not been completed or when the lender determines that sustaining occupancy will not exist at the time of closing. If special escrows are established at closing, they will be listed in the Mortgagee's Certificate and will be evidenced by escrow agreements executed by the owner and the lender. If special escrows were required, the lender must set up a system for monitoring the owner's draw down of these funds.

a. Escrow For Incomplete Repairs. An escrow for incomplete repairs is required when minor exterior repair items are not completed as of the date of the final inspection. HUD Handbook 4566.1, Coinsurance for Mortgage Lenders - Section 223(f), describes how this escrow is calculated and established. The lender may release the escrowed funds only after it has determined, through an on-site inspection, that the work has been satisfactorily completed. The lender may extend the time for completion if the lender determines that an extension is warranted and the delay is not due to the owner's inaction. If completion of necessary repairs is unreasonably delayed, the lender must arrange to get the work done using funds

available in the escrow account.

- b. Operating Deficit Escrow. An operating deficit escrow is required if the lender's analysis shows that the project will not achieve sustaining occupancy by the time of endorsement. HUD Handbook 4566.1 describes how the operating deficit is estimated. The escrow agreement, which is executed at loan closing, establishes the conditions under which the operating deficit may be used. The lender's loan servicing staff should thoroughly review the escrow agreement and the underwriting staff's projections of occupancy levels and income and expenses.

- (1) During the period covered by the escrow agreement, the owner must provide the lender with monthly reports on the project's operation. The reports must provide the lender with the information it needs to administer the escrow agreement. Usually, the owner will need to report on collections, outlays, accounts payable, cash balances and occupancy levels. If the escrow agreement requires the owner to implement specific management initiatives to increase occupancy, the owner must also report on the status and impact of those initiatives.

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- (2) The lender must review the owner's monthly reports. The lender must: (a) compare the project's actual occupancy levels and cash flow deficit with the occupancy and deficit projections on which the amount of the escrow was established; and (b) monitor the owner's implementation of any required management initiatives. If deficits are higher than projected, the lender should work with the owner to determine the cause of the deficit and to formulate corrective actions. If the project does not achieve sustaining occupancy by the end of the escrow period, the lender must notify the HUD Field Office of that fact and of how the owner intends to deal with the situation. Operating deficits should be computed on a cash, rather than an accrual, basis. Escrow funds may be released only in accordance with the terms of the escrow agreement. If the owner defaults and the lender accelerates the debt, the lender must apply any amount remaining in an operating deficit escrow to the mortgage debt.

#### 1-14. MONITOR IMPLEMENTATION OF REQUIRED MANAGEMENT IMPROVEMENTS.

If the lender required the project owner to undertake management improvements as a condition for obtaining coinsurance, the lender must closely monitor the owner's progress in completing the required actions. The form of the lender's monitoring may vary according to the nature of the required actions. Progress on maintenance and repairs should be monitored via on-site inspections. Actions required to

strengthen the project's financial condition (e.g., clearing payables, collecting receivables and marketing vacant units) should be monitored by reviewing monthly financial and occupancy reports submitted by the owner. Progress on other management improvements could be monitored by requiring the owner to submit periodic narrative reports. The lender must document all progress checks and the dates the tasks were completed. The lender must notify the HUD Field Office if there are significant delays in implementing corrective actions which could adversely impact the viability of the project.

- 1-15. ESTABLISH "TICKLER" SYSTEMS. As an important part of start-up servicing, the lender must set up tickler systems to alert staff to the dates that important initial and ongoing servicing functions are due. Exhibit 1-3 suggests items and dates for which ticklers might be appropriate.

### Section 3. Lender's Annual Reports to HUD

- 1-16. FINANCIAL AUDIT OF LENDER. The coinsurance regulations require the lender to submit an annual audit, similar to the audit which it filed as part of its application to become a coinsuring lender. The audit report must be prepared by a certified public accountant or an independent public accountant licensed on or before December 31, 1970. The auditor must have no business relationship with the lender except for the performance of the audit, systems work and tax preparation. The auditor must prepare the annual audit in accordance with HUD Handbook IG 4000.3 REV, Audit Guide for Audits of HUD Approved Non Supervised

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Mortgagees for Use by Independent Public Accountants. The audit report must include statements from the IPA as to (a) the outstanding principal indebtedness on mortgages in the lender's coinsured portfolio; (b) the amount of liquid funds available to the lender; and (c) the lender's sound capital resources. The lender must file its annual audit report within the time required by applicable State law, or, if there are no such State requirements, within 75 days after the closing of its fiscal year. The lender must send a copy of its annual audits to both the Office of Insured Multifamily Housing Development and the Office of Program Compliance (formerly Office of Lender Certification) in HUD Headquarters.

- 1-17. INVENTORY RECONCILIATION AND SERVICING REPORT. In March of each year, HUD Headquarters will generate a listing of each lender's coinsured loans and HUD will ask each lender to reconcile this information against the lender's records. HUD will ask the lender to add any projects not listed, supply any missing information, and correct any incorrect information. HUD will also ask the lender to report on servicing or monitoring actions (e.g., on-site reviews, rental increases,

default mortgage relief) taken on these projects. The lender must return the report within 30 days of its receipt.

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EXHIBIT 1-1

EXAMPLES OF LENDER ACTIONS WHICH REQUIRE ADVANCE HUD APPROVAL

Handbook  
Chapter

- 1 Changing key personnel or operating procedures approved by HUD
- 1 Selling a coinsured mortgage
- 2 Allowing prepayment of a coinsured mortgage sooner than five years after endorsement
- 2 Allowing the owner to use a hazard insurance settlement to pay for repairs when the mortgage is delinquent
- 3 Releasing funds from the residual receipts account of a non-profit or limited-dividend project
- 4 Approving a management agent or self-management by the owner
- 7 Approving rents in excess of those allowed by local rent control
- 8 Approving certain transfers of physical assets
- 9 Accelerating the debt for violation of the regulatory agreement
- 9 Executing an agreement to permanently modify the terms of a mortgage or approving certain types of temporary mortgage relief
- 10 Filing a Notice of Election to Acquire and Intention to File a Claim more than 75 days after the date of default
- 10 Self-managing an acquired project
- 10 Making repairs or improvements to an acquired project that would exceed a cumulative average of \$500 per unit
- 10 Charging less than market rents for units in an acquired project
- 10 Selling an acquired project to an individual or entity that has an identity-of-interest with the lender

- \* Allowing the project owner to engage in any other business or activity, including the operation of any other project.
- \* Assessing the owner for attorney, audit and other costs incurred In enforcing compliance with the regulatory agreement
- \* The regulatory agreement contains these provisions

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EXHIBIT 1-2

SUGGESTED CONTENTS OF SERVICING FILES

Controlling Documents	Development Documents Needed During Initial Servicing
Regulatory Agreement	Operating Deficit Escrow Agreement
Management Certification	Escrow Agreement for Incomplete Repairs
Mortgage/Deed of Trust	Letters of Credit
Mortgage Note/Deed of Trust Note	Firm Commitment Letter (containing any conditions related to required management improvements)
UCC Security Agreement and Financing Statement (if applicable)	Management Staff's Comments on Project's Application for
Mortgagee's Certificate	
Cost Certification (if applicable)	
Final Completion Inspection Report	
Title Insurance Policy	
Partnership Agreement or Other Evidence of Mortgagor's Organization	Escrows and Payments
Maximum Insurable Mortgage (HUD-92580) to determine initial owner's equity in the case of limited-dividend projects	Escrow Analyses
Mortgage Modifications	Correspondence on Loan Collections
Reinstatement Plans	Delinquency Notices Sent to Mortgagor and HUD
	Property Insurance Schedule (HUD-92329)
	Hazard Insurance Policy
	Amortization Schedule
Reserve for Replacements	Billings and Evidence of Payment for MIP, Taxes and Insurance
Analysis of the Reserve for Replacements	
Correspondence on Withdrawals, Changes in Deposits, investments, etc.	Rents and Budgets
	Original Rent Formula
	Correspondence on Requests for Increases
On-Site Reviews	Approved Rent Schedules (HUD-92458)
	Rent Computation Worksheets (HUD-92547A)
Management Review Report Completed prior to Endorsement	

Ongoing Management Review Reports	
Annual Physical Inspection Reports	Project Financial Statements
Correspondence Relating to Corrective Actions	Monthly Reports (when required) Annual Audited Statements Lender's Analyses of Annual and Monthly Reports
General Correspondence	Correspondence on Financial Reports
Management Agent Profile	

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EXHIBIT 1-3  
SUGGESTED TICKLERS FOR LOAN SERVICING  
AND MANAGEMENT OVERSIGHT

Item	Dates
Escrow Agreements	Expiration Dates
Letters of Credit	Expiration Dates
UCC Continuation Statements	Expiration Dates
MIP	Billing and Payment Due Dates
Insurance	Date Policy Expires
	Premium Payment Due Dates
Real Estate Taxes	Date Payment Due
Escrow Analyses	Date Annual Analysis Due
Annual Financial Statements Statements	60 Days After End of Project Fiscal Year
	Date Owner Response to Lender's Review Findings is Due
Physical Inspections	Date Annual Inspection Due
	Target Completion Dates for Required Repairs
Management Reviews	Date of First Management Review
	Target Completion Dates for Required Corrective Actions