Chapter 14.
PARTIAL PAYMENT OF CLAIMS
LOAN MODIFICATIONS

Section 1. GENERAL INFORMATION

14-1. INTRODUCTION

This Chapter provides guidance when circumstances beyond the owner's control result in a default of the insured mortgage. It may be in HUD's best interest to pay a Partial Payment of Claim (PPC) or authorize the modification of an insured note. This process is intended to assist the owner[1] with meeting project debt obligations. Potential benefits include preserving or providing affordable housing, stabilization of project operations, curing the existing default, and maximizing returns to the insurance fund.

A PPC pays the mortgagee a portion of the unpaid principal balance and recasts a portion of the mortgage under terms and conditions determined by HUD, as an alternative to assigning the entire mortgage. Prior to the Department's processing of the PPC proposal, the mortgagee must voluntarily agree to accept a partial payment of the insurance claim in accordance with the terms detailed in this chapter. The mortgagee must also waive any prepayment and lock out provisions in the mortgage. HUD will waive the deduction of one percent of the mortgage funds advanced to the mortgagor, provided for in 24 CFR 207.259(b)(2)(iv), with respect to a partial payment of claim. (See 24 CFR 207.258(b)).

The formal PPC process begins when the mortgagee is eligible to assign an insured mortgage in accordance with 24 CFR 207.258 to HUD and reinstatement is unlikely. Even prior to this point, the owner should discuss the property's financial difficulties with HUD's Project Manager and the mortgagee. The owner must provide Monthly Accounting Reports to the Hub/Program Center, once the difficulties are evident and prior to any request for a PPC.

A loan modification may be appropriate when an adjustment in the current mortgage terms, such as a reduction in the interest rate, may cure or prevent a default absent owner contribution. If the mortgage is under a lock-out and/or a penalty provision, the requirements of Mortgagee Letter 87-9 are met by following the requirements of this Chapter. The process for requesting, reviewing and approving a mortgage modification (or refinancing per Mortgagee Letter 87-9) will be the same as a PPC, except for the closing process.

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[1] HUD uses owner as a single reference to include but not be limited to principal, mortgagor and mortgagor entity. It may also refer to the controlling individual in an ownership entity, for example, managing member or general partner.

If the mortgagee agrees to accept a PPC, or the owner is requesting HUD override a mortgage modification, the owner must submit a proposal in accordance with the terms and conditions of this chapter to the HUD PPC Processing Office for review. (Processing Offices will be posted on the internet.) The submission must be signed by a legally authorized agent of the owner/mortgagor. The PPC Processing Office will work with the Program Center and/or Hub to review the owner's proposal. If the Processing Office Director concurs with the proposal, it must be forwarded to HUD Headquarters, Office of Asset Management for concurrence and final approval.

14-2. MORTGAGES THAT ARE ELIGIBLE FOR A PPC OR MODIFICATION UNDER THIS CHAPTER

Section 207: Multifamily Housing Mortgage Insurance

Section 213: Cooperative Housing Mortgage Insurance

Section 220: Mortgage Insurance for Urban Renewal

Section 221(d): Low-cost and moderate-income mortgage insurance-except for coinsured or formerly coinsured

Section 223(f): Except for coinsured or formerly coinsured

Section 542(c): HFA Risk Share

Note: Projects reinsured under Section 223(a)(7) are only eligible if the original mortgage (before reinsurance) was insured under one of the programs above. Mortgages must have completed final endorsement before a PPC will be considered.

14-3. MORTGAGES THAT ARE INELIGIBLE FOR A PPC OR MODIFICATION UNDER THIS CHAPTER

24 CFR 203: Single Family Mortgage Insurance

24 CFR 257: Hope For Homeowners Program

24 CFR Part 234: Condominium Ownership Mortgage Insurance

24 CFR Part 232: Health Care

24 CFR Part 236: Mortgage Insurance and Interest Reduction Payment for Rental Projects

24 CFR Part 242: Hospitals

24 CFR Part 244: Group Practice Facilities

24 CFR Part 251: Coinsurance for the Construction or Substantial Rehabilitation of Multifamily Housing Projects

24 CFR Part 255: Coinsurance for the Purchase or Refinancing of Existing Multifamily Housing Projects (i.e., projects coinsured under 223(f))

Formerly coinsured mortgages that have been converted to full insurance under Section 207 of the National Housing Act including Section 221(d) of the National Housing Act.

The Office of Multifamily Housing has elected not to exercise the authority under Section 541 of the National Housing Act to process PPCs with respect to the types of multifamily projects listed in this Section and lacks authority to process PPCs for hospitals, group homes or health care facilities.

Section 2. REGULATORY REQUIREMENTS

14-4. APPLICABLE REGULATION FOR a PPC

The applicable regulation for PPC is 24 CFR Part 207.258b titled: Partial payment of claim. Accordingly, prior to the approval, the Federal Housing Administration (FHA) Commissioner must, at a minimum, make the following findings:

A. The mortgagee is entitled, after a default under 24 CFR 207.255, to assign the mortgage in exchange for the payment of insurance benefits;

B. The relief resulting from partial payment when considered with other resources available to the project would be sufficient to restore the financial viability of the project;

C. The project is or can (at reasonable cost) be made structurally sound;

D. The management of the project is satisfactory to the FHA Commissioner, as shown by a rating of at least satisfactory on the most recent management review;

E. The default under the insured mortgage was beyond the control of the owner;

F. The project is, or potentially could serve as a low and moderate-income housing resource;

G. The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and other liens approved by the FHA Commissioner;

H. The mortgagee has voluntarily agreed to accept PPC under the mortgage insurance contract and to recast the remaining mortgage amount under terms and conditions prescribed by the FHA Commissioner, and

I. The owner has agreed to repay to the FHA Commissioner an amount equal to the partial payment, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the FHA Commissioner. The terms of the second mortgage will be determined on a case-by-case basis to ensure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast insured mortgage.

Section 3. OWNER AND MORTGAGEE REQUIREMENTS

14-5. THRESHOLD REQUIREMENTS FOR A PPC OR MORTGAGE MODIFICATION

A. The owner must meet the regulatory requirements set forth in Section 14-2 above before HUD requests the mortgagee to participate in a PPC. (Although the regulatory requirements are not applicable for a mortgage modification, the provisions will be considered in processing a mortgage modification.)

B. The owner must not have any other loans in any of HUD's multifamily housing programs that are in default (unless any default was beyond the control of the owner, such as the justification for a PPC), and the owner must not be in violation of any HUD regulatory or business agreements, including Housing Assistance Payment (HAP) contracts or Use Agreements with HUD.

C. The owner must have made after final endorsement or agree to make a net capital contribution equal to or greater than 5 percent of the original mortgage amount. No PPC or mortgage modification will be approved prior to final endorsement and contributions made prior to final endorsement will not be considered in the 5 percent calculation.

D. For PPC's the owner's cash flow projections must reflect the ability to support a recast new insured mortgage of at least 50 percent of the current outstanding mortgage with a debt service coverage ratio, including MIP of 1.20. For mortgage modifications, cash flow must support 100% of the current outstanding mortgage. (See 14-8 H for a further discussion).

E. The owner must have submitted and continue to submit all net cash monthly to the mortgagee once the loan is in default.

F. The mortgagee must submit a letter agreeing to accept a PPC or mortgage modification with terms consistent with the requirements of this chapter.

14-6. MORTGAGEE TERMS

The interest rate for underwriting/approval purposes will be at 125 basis points over the 10-year Treasury Rate (rounded to the nearest tenth) at the time of HUD approval. Mortgagees are encouraged to place the loan at a lower rate. Any reduction from the approved rate will provide additional cushion to the recast note and will benefit the owner and project on a long term basis.

Late fees accrued since the last payment or any other costs to close cannot be included in the transaction or paid by the project in the future.

HUD will include in the PPC note amount, interest computed from the “Paid Through Date” on the mortgage based on the actual number of days in a 365 or 366 day year. The mortgagee cannot collect more interest from the project than paid by HUD.

Cash held in suspense by the mortgagee will be allowed by HUD to be used at closing to pay reasonable closing attorney fees, title and recording fees, escrow shortages, actual bond or GNMA fees and interest for the remainder of the closing month. The PPC will not be increased if project cash is insufficient to cover these costs.

The mortgagee must agree that any prepayment lock-out and/or penalty provisions are overridden by the PPC or approved mortgage modification.

The mortgagee cannot charge the project a fee for processing a PPC or mortgage modification.

14-7. PROPOSAL SUBMITTED BY THE OWNER

The proposal from the owner must be submitted within 60 days of default. The Hub/Program Center (PC) should not approve any Extensions of Election to Assign for a full claim unless a complete owner’s package, as detailed below, has been received by the PPC Processing Office. In making a request, the owner shall provide the following to the PPC Processing Office (with a copy to the Hub):

A. A cover letter stating the parameters and conditions of the owner’s request. The owner must provide:

1) The amount of a recast first mortgage that is supportable by cash flow.

2) An anticipated closing date, generally within 4 months from the date of the request.

3) A discussion of the problem(s) that caused the default.

4) Steps that have been taken to overcome both past and present problem(s).

5) A discussion of how the PPC request meets all of the Regulatory requirements of 14-2.

6) If any part of the submission requires a waiver to any handbook or regulation, a discussion of what waiver is needed and why it is in HUD's best interest to waive the requirement.

B. A statement of net owner contributions. Owner contributions must have been in the form of cash, however for a non-profit, in-kind services may be considered. Accrued but unpaid Identity of Interest (IOI) expenditures (management, ground lease, or similar) generally may not be considered, but if requested and approved by HUD, these unpaid fees must be converted to a note and future (post PPC closing) fees must be treated similarly for years in which surplus cash is negative. A certified statement by an independent public accountant or a certified public accountant must be provided showing all advances and repayments to the owner. This statement should include, but is not limited, to the following:

1) Contributions/advances made since final endorsement;

2) Distributions made to the owner since final endorsement;

3) Repayment of advances or contributions since final endorsement; and

4) The total net advances.

Owner contributions can only be repaid from future distributions of the owner's share of surplus cash.

C. Copies of current year budget, most recent interim statement, and the last three fiscal years audited financial statements must be submitted. These statements must also be used to develop and provide projections for 10 years post PPC closing. Projections should detail trending assumptions, and any changes in operations that result in deviations from historical results.

D. A discussion with exhibits concerning the property's condition and adequacy of the replacement reserve account and projected reserve contributions for 10 years post PPC Closing. A Project Comprehensive Needs Assessment (PCNA) or an update from a report no older than 5 years from the date of the PPC request must be completed by an independent third party contractor using HUD guidelines if any of the following exist:

1) The property has reserves of less than $250/unit.

2) The property is older than 10 years, based on final endorsement date.

3) The property has a Real Estate Assessment Center (REAC) physical inspection score below 80 points. Under this requirement only, a PCNA can be waived by the Hub prior to submission. The Hub will consider the specific deductions in the REAC report and results from any site visits by HUD or PBCA staff in determining whether a PCNA is necessary.

HUD will not grant any extensions to of the election to assign the mortgage due to submission delays or packages returned due to the lack of a PCNA.

E. Response to the latest Management Review and Physical Inspection Report. If the project received a less than satisfactory rating in any section of the management review or any deficiencies on the last HUD physical inspection, the owner must provide written comments regarding the status of any corrective action in progress, that is, what repairs have been completed, what other corrective actions have been taken, and target dates for completing these actions.

F. The current rent roll showing units and commercial space occupied and rents charged. Copies of all commercial leases must be submitted.

G. Additional information to support the PPC request, including but not limited to letters reflecting local support, how the property is providing or will provide needed affordable housing, and any other related information.

H. A statement that the owner and all lien holders will agree to accept a Use Agreement that will be superior to all liens, including the recast first mortgage. The Use Agreement will have a maturity of 20 years from the date of the PPC closing. The Use Agreement will also specifically state that the property cannot discriminate against Section 8 voucher holders.

   If the property is already covered under a Land Use Restriction Agreement (LURA), the HUD Use Agreement may mirror the LURA requirements.

   For all other properties, the HUD Use Agreement will require at least 30 percent of the units be reserved for residents with incomes at or below 80 percent of Adjusted Median Income (AMI) at rents not to exceed 30 percent of 80 percent of AMI. Owners may request a lower percentage of units (not less than 10 percent) and/or higher percentage of AMI than 80 percent, but they must justify the requested modification through comparative modeling, market studies reflecting demand for affordable housing, current tenancy, and property support through owner contributions.

Attached as Appendix A is a PPC Document Check Sheet

Section 4. FIELD AND HEADQUARTERS REVIEWS

14-8. PPC PROCESSING OFFICE ANALYSIS

The PPC Processing Office will review and analyze the owner's proposal and request additional information from the owner as necessary. The assigned review office and primary reviewer must coordinate information from a number of sources and systems within HUD. This includes the

Hub/Program Center and Project Manager (if not the primary reviewer), staff appraisers, Economic and Market Analysis (EMAS) reports and staff, the Online Property Integrated Information Suite (OPIIS), the Multifamily Delinquency and Default (MDDR) reporting system, and the Active Partner Performance System (APPS).

The PPC Processing Office analysis must utilize the **PPC Analysis Model**. The most recent version of the model is available on the internet at http://hudatwork.hud.gov/po/h/hm/fog/misc.cfm. Owners or their representatives may utilize the model, but the PPC Processing Office must rename the owner's model and make changes as appropriate. A discussion of any differences from the owner's submission must be noted within the model or separate write-up. OPIIS peer information can only be added by HUD staff.

Once the owner's package is received the PPC processing Office must determine that the owner's submission is complete and meets the threshold requirements under Section 14-5. This step should be completed within 10 days of receipt of the owner's submission. If the submission is incomplete, it must immediately be returned to the owner. If the Election to Assign date is imminent, then the owner will have to choose between leaving the process or providing an advance to prevent the assignment.

The PPC Processing Office Director's decision to reject or accept a PPC or mortgage modification proposal should be based on the following analysis:

A. Verify that the owner is in compliance with all business agreements with the Department. Utilize APPS to see if ownership and/or management are involved with other properties and note any flags related to those properties to assist in the analysis.

B. Verify the owner's contributions by reviewing the project's financial statements. Contributions must be shown on the Statement of Cash Flows. The analysis should verify that the contributions are actually from the owner and not (re)deposit of project funds, and that all contributions were made after final endorsement. Funds deposited due to calls on Letters of Credit shall not count as owner contributions. The owner's contribution ratio must equal or exceed 5 percent of the original mortgage balance. The contribution ratio is calculated by dividing the net capital contributions by the original mortgage balance of the insured mortgage.

C. Determine that the owner and management agent have the capability to resolve current and future problems. Analyze the owner's discussion of the problem(s) that caused the default and steps taken to overcome both past and present problems(s). The analysis must include a review of HUD files and systems to validate that the problems were beyond the control of the owner. Available Management and Occupancy Reviews (MOR) must be analyzed. If a MOR has not been conducted recently a site visit by Hub/Program Center staff to review project operations is strongly encouraged. Separate paragraphs covering owner and management agent capacity should be prepared. The PPC Processing Office should generally not recommend approval contingent on changing the management agent as the lack of a change prior to submission negatively reflects on ownership, plus a change in the management agent may impact the stability of income and/or expenses, perhaps positively, but potentially negatively.

D. Review Monthly Accounting Reports to determine if all net cash is being remitted to the mortgagee. Analyze Monthly Accounting Reports for consistency with the owner's projections for income and expenses and to ensure that funds are spent only on reasonable and necessary operating expenses.

E. Use the **PPC Analysis Model** to determine base year (first full year after PPC closing) Net Operating Income (NOI). The PPC Processing Office must review the project's income, expenses, vacancy rate, and NOI submitted by the owner and make adjustments where necessary. The following four categories must be discussed in any submission to Headquarters:

    1) Income: Besides rent, other sources of income and adjustments must be looked at. This may include, but is not limited to parking, commercial space, laundry, tenant charges and historical bad debt. The impact of the proposed use restriction should be examined.

    2) Economic vacancy rate: This is verified by reviewing the current rent roll and comparing these rents with the approved rent schedule. Note: The economic vacancy rate takes into consideration the concessions and rent reductions that the owner may have used to increase the physical occupancy of the project. Because of concessions like these, the project may have a reasonable level of units occupied, but the income may be insufficient to pay all expenses and debt service. The economic vacancy should show a flat to decreasing trend over the last 6 months.

    3) Expenses: These are determined by reviewing historical data (annual and interim), current year budgets and post closing projections. This process is similar to the review of an owner's request for a budget based rent increase.

    4) Replacement Reserves: Analyze the balance in the replacement reserves, taking into account any suspension of deposits, age of the property and physical condition reports to ensure that at closing of the PPC, the replacement reserve account is adequate and that future monthly deposits will be sufficient for the property's needs.

F. Analyze past performance of the property and compare expense results to peers using OPIIS or similar information. Significant unexplained deviations from peer properties may indicate a property in which the default may have occurred in part due to ownership actions and not be appropriate for a PPC. Consultation with staff appraisers and other HUD development staff should be part of this analysis step.

G. The model will calculate a supportable first mortgage. In making the calculations, the interest rate on the recast mortgage must be 125 basis points over the current 10-year Treasury Rate (rounded to the nearest tenth.) A minimum Debt Service Coverage Ratio (DSC) including Mortgage Insurance Premium (MIP) of 1.20 is required for the base year. If projections reflect that the DSC in future years will fall below 1.20, a Letter of Credit (LOC) or similar assurance is required to cover projected cash flow deficiencies. See 14-10 C. 1 for LOC Terms.

For PPCs only: If the supportable first mortgage is less than 50 percent of the unpaid Principal balance (UPB), and no waiver is granted, the owner should be contacted and offered an opportunity to increase the owner contribution. (If the 50 percent test is not met solely due to an increase in interest rates since submission, no additional owner contribution will be required.) The additional owner contribution required will be the current principal outstanding divided by 2, minus the supportable first mortgage. The owner must respond and agree in writing within 5 business days, otherwise the PPC must be rejected.

H. The model will calculate the amount of the PPC second mortgage. HUD will include in the second mortgage all interest owing at the current First Mortgage Note Rate (less any additional contributions required to achieve the 5 percent contribution requirement). All fees and late charges must be waived by the mortgagee. The PPC second mortgage will have a maturity date equal to the first mortgage, be callable at maturity of the Use Agreement, have an interest rate equal to the Adjusted Federal Rate for the month of closing, and require payments equal to 75 percent of surplus cash annually after filing of the annual financial statement. This paragraph is not applicable for mortgage modifications.

14-9. PPC PROCESSING OFFICE DIRECTOR'S DECISION AND HEADQUARTERS' PROCESSING

The PPC Processing Office Director is authorized to reject any PPC or mortgage modification proposal. If the proposal does not meet the requirements explained above, the PPC Processing Office Director will send a registered rejection letter to the owner. The owner has 15 calendar days from receipt of the rejection letter to provide additional information to the PPC Processing Office Director and request reconsideration of the request. If the request is again rejected, the owner has five business days to submit an appeal to Headquarters. The Headquarters appeal must address the reasons for the rejection and the mitigating factors that exist for continuing a review of the request by the PPC Processing Office. After any appeals period has expired, the mortgagee will be instructed by the PPC Processing Office Director to process a full claim, if the mortgage is not reinstated.

Once the PPC Processing Office Director determines that a PPC or mortgage modification is approvable and that management and ownership have the capability to handle current and future problems, a written summary of the transaction should be directed to the Director of Asset Management in Headquarters. See Appendix A, PPC Document Check Sheet.

Within (5) five business days, Headquarters should discuss any issues that the narrative or model raises with the PPC Processing Office. Once Headquarters' concerns have been resolved, the model will be modified to reflect that day's first mortgage interest rate (125 bp over the 10 year Treasury rate). Headquarters will prepare an Approval letter with Terms and Conditions to be sent to the owner and mortgagee.

If the mortgagee and owner accept the PPC proposal, no further payments should be applied to the mortgage. The mortgagee should continue to collect all net cash but maintain these funds in a suspense account. This is not applicable for mortgage modifications. If a PPC or mortgage modification has been approved, GNMA will allow the transaction to proceed, regardless of the payment status.

Section 5. Closing Requirements

Headquarters staff in the Office of Asset Management will collect all documents detailed below from the Hub, PPC Processing Office, owner, and mortgagee. Upon receipt, the documents will be reviewed for consistency under the approved Terms and Conditions and distributed to the appropriate staff within the Office of General Counsel (OGC) and the Multifamily Claims Branch.

14-10. Mortgage Terms

A. The First Mortgage will be modified to reflect:

1) A reduced principal mortgage.

2) A maximum interest rate of 125 basis points over the 10 year Treasury Rate (rounded up to the nearest fifth or tenth) at the time of HUD's approval.

3) The original maturity date.

4) Monthly payments that are re-amortized based on 1, 2, and 3.

5) If requested by the mortgagee, the Mortgage Note may include a restriction on prepayment for the purpose of enhancing the marketability of the new GNMA Mortgage-Backed Security. Any prepayment restriction must be in accordance with Mortgagee Letter 87-9.

6) If the mortgage servicer is unable to offer or place a recast mortgage with a GNMA investor at the rate approved above, HUD may consider a modification to the rate and size of the recast mortgage. To obtain a higher rate, the mortgage servicer must certify to HUD, Director of Asset Management, that they have made their best efforts to place the loan at the approved rate. As part of this certification, they certify they have provided the secondary market the following terms:

   a. DSC including MIP and deposits to the replacement reserves of 1.20.

   b. Inclusion of lockout and prepayment penalty

   c. 20 year Use Agreement and 20 year call provision.

d. IOI cash flow pledged in years of deficit surplus cash.

e. Cash flow dependant upon the PPC model's underwritten economic vacancy percentage the base year.

f. Minimum of 3 bids that will result in the placement of the recast mortgage in a REMIC transaction.

g. Documentation of information provided to investors must be retained for 3 years for HUD review at the servicer's office. If in compliance, proprietary information will not be copied or retained by HUD.

If requested, HUD will make available their approved underwriting model.

Should a certification be received, HUD will allow the rate to increase by 50 basis points without further HUD approval.

B. The terms of the second mortgage will be as follows:

1) An interest rate equal to the Applicable Federal Rate for the month of closing.

2) Maturity date co-terminus with the first mortgage.

3) A "due-on-sale, refinance, or termination" provision.

4) As long as the Note is held by HUD, a service charge calculated at 0.5 percent annually based on the unpaid principal balance of the HUD-held Second Mortgage must be paid to HUD monthly.

5) The minimum annual payment on the HUD-Held Second Mortgage will be 75 percent of annual surplus cash as specified in the Regulatory Agreement between the Secretary of Housing and Urban Development and the project owner together with the applicable HUD Regulations and administrative requirements. The surplus cash payment is due within 10 days of the required filing of the Annual Financial Statement. Owner's share shall be twenty five (25) percent and remain available to meet project obligations, including authorized distributions. The minimum annual payment will be applied towards interest first and then principal.

6) A call provision equal to the maturity date of the Use Agreement at which time HUD, or the Second Note Holder, at their sole option, may require the full payment of, or provide the owner the opportunity to propose a restructuring of the debt.

7) Language prohibiting successors and assigns of the beneficiary of the Second Deed of Trust Note from imposing property insurance requirements that exceed the original principal balance contained in the First Mortgage or Deed of Trust Note or are in

addition to those required by the First Deed of Trust Holder or First Mortgage Note Holder so long as the First Mortgage Note is insured by the Secretary of Housing and Urban Development.

8) HUD has the right to sell the HUD-Held Note. If HUD sells the HUD-Held note, the owner is required to submit annual financial statements to the note holder in the same form as submitted to HUD.

C. Other Terms and Conditions of the PPC transaction:

1) If a Letter of Credit or equivalent is required as a condition for approval, and should, surplus cash, as defined by HUD, be less than zero for fiscal years ending during the term of the Letter of Credit, the mortgagee shall draw upon the Letter of Credit an amount equal to the negative surplus cash amount. The draw will occur 10 days after the filing of the Annual Financial Statement. If the property does not file an Annual Financial Statement timely during the term of the letter of credit or no statement has been filed prior to maturity date of the Letter of Credit, the full balance of the Letter of Credit will be drawn upon. All draws on the Letter of Credit will be deposited into a special escrow account. Withdrawals will require approval by the HUD Field Office, using Form HUD-9250. Repayment of the Letter of Credit can only be made from the owner's share of surplus cash in future years and shall not result in a lien on the property.

2) If IOI expenditures have been included as an Owner's Contribution in calculating eligibility for a PPC, then a requirement that those expenditures cannot be taken or must be re-deposited for any year in which surplus cash is negative (not to exceed the amount of the negative surplus cash amount.) The redeposit or accrual can only be repaid from the owner's share of surplus cash in future years.

3) The monthly deposit to the Reserve for Replacement Account (RFR) will resume with the first payment of the recast first mortgage. (Previous deposits will not have to be made up, unless the reserve balance has been determined to be inadequate).

4) All escrows, such as tax, hazard insurance and mortgage insurance premium (MIP) shall be fully funded at closing.

5) All payables older than 30 days must be converted to notes payable and can only be repaid from the owner's share of surplus cash or paid by the owner prior to closing.

6) Under no circumstances may changes be made to the documents reviewed other than to conform to the terms and conditions of this approval, without HUD's specific authorization. The Hub/Program Center Counsel, in consultation with Headquarters' Office of General Counsel, may modify the documents to conform to local legal requirements.

7) If the insured First Mortgage is repaid, the owner must establish and maintain continued funding of all escrows required by the First Mortgage until the second is repaid in full.

8) If at any time during the term of this agreement, HUD determines that there has been an uncorrected material violation of a Regulatory Agreement, Housing Assistance Payments Contract, Use Agreement, or any other contractual or Regulatory provision governing the operations of this project, the interest rate on the HUD-Held Second Mortgage will revert to the original Note Rate, the rate on the First Mortgage existing prior to the Modified Insured First Mortgage, retroactive to the date of the closing.

9) Project operating income may not be used to pay financing fees, attorney fees, consultant fees, other professional fees, or any other costs of the restructuring transaction. The owner's share of future surplus cash may be used for these purposes only if available for distribution in accordance with HUD regulatory requirements and applicable policy guidelines.

10) Cash held in suspense by the mortgagee will be allowed by HUD to be used at closing to pay reasonable closing attorney fees, title and recording fees, escrow shortages and interest for the remainder of the closing month. The PPC will not be increased if project cash is insufficient to cover these costs.

11) HUD will include in the PPC Note the amount of interest computed from the Paid Through date to the date of closing based on the actual number of days in a 365 or 366 day year. The mortgagee cannot collect more interest from the project than paid by HUD. Late fees accrued since the last payment or any other costs to close cannot be included in the transaction or paid by the project in the future.

12) Sources and Uses of Funds Statement for this refinancing may not show disbursements of funds to the owners.

13) No funds may be paid to identity-of-interest persons or entities. The Sources and Uses of Funds Statement must also be signed by the Owner or representative below the following statement:

"Warning: It is a crime to knowingly make false statements to a Federal Agency. Penalties upon conviction can include a fine and imprisonment. For details, see Title 18, U.S. Code 1001 and 1010."

14) The owner and the servicer/lender of the first mortgage loan must provide notices and documentation to the second note holder upon the occurrence of events that could affect the value and position of the second mortgage lender such as: full or partial payment of principal on the first mortgage loan; events of default on the first mortgage loan; declaration of bankruptcy by the owner and any documentation related to a bankruptcy or any foreclosure action.

15) In the event the first Mortgage is prepaid and there is no additional debt with HUD mortgage insurance, the owner will furnish HUD and the note holder audited annual financial statements until the PPC Note is satisfied.

16) The owner may not incur additional debt without the prior written consent of HUD and the note holder.

17) The note holder (subject to the rights of the first mortgage lender) has the right to foreclose on the security interest in the net cash flow perfected by filing of a UCC 1 Financing Statement, in the event of a default on the Note.

14-11. REQUIRED LEGAL CLOSING DOCUMENTS AND REVIEW

A. Ten business days prior to the closing date, the owner must submit two full sets of the required legal documents - one set to OGC Counsel in Headquarters and one set to the appropriate Field Counsel. Failure to submit the closing documents 10 days prior to the closing will delay the closing. Required legal documents must be submitted in an acceptable format.

B. The Field Counsel will review the legal documents for compliance with local law.

C. The list of the legal documents that are generally required includes, but is not limited to the following:

1) Modification of Note and Mortgage/Deed of Trust

2) Modification of Security Agreement

3) Second Note

4) Second Mortgage/Deed of Trust

5) Subordination of any additional liens

6) Amendment to Regulatory Agreement

7) Regulatory Agreement for PPC mortgage

8) UCC Financing Statements

9) Title Endorsements and Commitments and a new Title Policy for the second PPC mortgage

10) Use Agreement

11) Good Standing Certificate of Borrower

12) Attorney's Certification to HUD: No Change to Documents

14-12. CLAIMS BRANCH PROCESS

The total of the PPC will be determined by the certification of mortgage balance (Certification) from the servicing mortgagee after the application of remaining net cash proceeds and all unapplied funds. The Certification should include all escrow balances and must be signed by the mortgagee and the owner.

HQ Asset Management will obtain the following documents for the Multifamily Claims Branch 10 days prior to the scheduled closing:

1) The current Mortgage Deed and Mortgage Note

2) Modification Agreement/Allonge (if any)

3) Closing Memo 290

4) Regulatory Agreement

5) HUD Forms

    a) 2537 Mortgagee's Application for Partial Settlement

    b) 2747 Application for Insurance Benefits

    c) 1044-D Payment Information Treasury Financial Communication System

6) Payment Authorization to a third party (third party to complete 1044-D if appropriate)

7) Notice of Default (MDDR)

8) Amortization Schedule

9) Certification of Mortgage Balance

    Working with the Office of Asset Management, the Claims Branch will verify the current note's Unpaid Principal balance (UPB) and calculate the mortgage interest owing, based on the date of the last payment to the date of closing (based on a 365 or 366 day year). Five days prior to closing, the Office of Asset Management will provide to the Claims Branch a Closing Memorandum detailing the application of the claim payment to interest and principal. As part of the Closing Memorandum, a Sources and Uses Statement will be attached.

14-13. SCHEDULING THE CLOSING

HUD must be notified of the targeted closing dates as soon as possible. The owner's requested dates will be accommodated whenever possible. However, HUD has the final authority to set the closing date.

Within five (5) business days of owner acceptance, HUD Headquarters will coordinate with OGC Counsel in Headquarters and Multifamily Claims Branch to provide a projected closing date or will give alternative dates based on the availability of HUD personnel. Once a closing date is established the closing should occur on schedule and will proceed accordingly, since various offices within HUD are involved in the PPC transaction. HUD must move forward early with a definite closing date in mind in order to accomplish the various steps in the process. Delays due to mortgagor/mortgagee or other party's action or inaction will be deemed the mortgagor's responsibility. The owner is strongly encouraged to meet the targeted closing dates, as delays may be costly. Once the amount of the PPC note is determined, any increase in the funds required to close (i.e., interest) must be funded by the owner at closing.

The closing must occur within 60 days from the date of notification of PPC approval. Otherwise HUD's approval will be null and void.

The original signed and fully executed closing documents, along with supporting documentation showing compliance with all the terms and conditions of approval must be submitted to the Headquarters' Office of the General Counsel. One copy of the documents must be sent to the respective Director, Multifamily Hub, and one copy to the Director, Office of Asset Management. The closing documents and required certifications are to be submitted in the form prescribed by HUD Counsel and signed by the owner's counsel, as appropriate.

Section 6. POST-CLOSING REQUIREMENTS

14-14. POST CLOSING REQUIREMENTS

A. Headquarters: Immediately after closing, the 2nd mortgage note must be delivered to the Office of Multifamily Notes Servicing. A copy of the recast first note and mortgage must be provided to the Office of Multifamily Insurance Operations, to ensure that MIP is properly calculated post closing.

B. Field: As long as the PPC note is owned by HUD, the Project Manager must compare the Annual Financial Statement submitted by the owner to the final HUD-approved base line and 10-year projections. This step must be completed within 60 days of the owner filing the annual statement. Significant deviations should be investigated to ensure all income and expenses plus reserves and accounts payable are properly accounted for and that surplus cash is accurate. An example of an improper practice would be running the cost of a replacement reserve item through expenses, rather than requesting a withdrawal from the reserve. This will have the effect of inflating expenses and reducing surplus cash, of which 75 percent must be paid on the second mortgage. Expenses should also be closely examined to ensure no expenses have been incurred related to the PPC. All accounting, legal, and consultant fees must be paid for by the owner and not out of project accounts.

If a Letter of Credit has been taken as part of the PPC, the Project Manager must verify if any draws are required and take action to enforce the terms.

After completion of the financial statement analysis, the Project Manager is required to summarize the analysis into iREMS. This must be completed annually as long as HUD is the holder of the PPC mortgage or a Letter of Credit is outstanding.

The Project Manager should follow established protocol to ensure filing of accurate financial statements and that required payments are made on the PPC note.

Appendix A
PPC Document Check Sheet

Owner Submission to PPC Processing Center:

- ☐ Cover Letter
  - Discussion of problems leading to the default
  - Steps taken to overcome past and present problems
  - Discussion on how the project meets Regulatory and Threshold requirements
  - Justification of any waiver request
  - Any additional financial support that could be utilized (Letter of Credit, guarantees, etc)
- ☐ CPA Statement on Owner Contributions
- ☐ Current Year Budget
- ☐ Most Recent Interim Financial Statement
- ☐ 3 Years Audited Statements
- ☐ 10 year projections, including narrative discussion of each significant income and expense account that is inconsistent with past results
- ☐ PCNA (If required by guidelines or requested by HUD)
- ☐ Appraisal (If requested by HUD)
- ☐ Responses to previous Management Reviews or Physical Inspection reports
- ☐ Rent Roll
- ☐ Agreement to accept a Use Agreement

Processing Center Submission to HQ:

- ☐ HUD PPC Model
- ☐ Written Summary of the Transaction that includes:
  - Discussion on Ownership and Management
  - Discussion on Property Condition
  - Use Agreement Requirements
  - Discussion on Policy Deviations
  - Discussion of significant income and expense accounts that are inconsistent with past results or owner request (comments within the model may be sufficient)
- ☐ Owner Cover letter

Pre-Closing Documents from the Program Center (Can be included in Submission packet)

- ☐ Monthly Accounting Report
- ☐ Copy of Note
- ☐ Copy of Mortgage and any modifications
- ☐ Copy of Regulatory Agreement
- ☐ Copy of Original 290