CHAPTER 5. PREVENTING MORTGAGE ASSIGNMENTS

SECTION 1. INTRODUCTION

5-1. PURPOSE. There are many conditions which may cause defaults or a mortgage to be assigned. Many of these conditions can be eliminated, thus avoiding default or assignment, by timely recognition by the Field Office and mortgagee and prompt corrective action by the mortgagor. The action that can be taken will vary depending on the type of default, and the rights and responsibilities of the mortgagee, the mortgagor, and HUD under the basic documents, contracts, and/or agreements. This Chapter is designed to provide guidance to the Field Office in preventing assignments of HUD-insured mortgages.

5-2. TYPES OF DEFAULT. The causes and cure for defaults will differ and any corrective action must include the cooperation of the mortgagor and mortgagee.

A. Monetary Default - Failure of the mortgagor to pay any installment payment due, including payments due under any operating loss loan on any mortgage insured by HUD. The delinquency must have continued for 30 days.

B. Mortgage Covenant Default - Failure by the mortgagor to perform any covenant due under the provisions of the mortgage.

C. Technical Default - Failure by the mortgagor to perform any covenant due under the provisions of the Regulatory Agreement.

SECTION 2. PREVENTING DEFAULTS

5-3. RECOGNITION OF POTENTIAL DEFAULTS. Prompt and accurate identification of the causes of default or of impending default is imperative. The Loan Management Branch staff should utilize the following resources in assisting them in identifying possible defaults: 1) Annual Physical Inspection Report; 2) Management Review Report; 3) Multifamily Unit Inspection Report or Summary; 4) the Early Warning System for Multifamily Housing projects; and 5) financial statements submitted by the mortgagor. Upon receipt of a late notice from the mortgagee, the Loan Management Branch staff should contact the mortgagor to determine the cause for late payments and what corrective action, if necessary, must be taken.

5-4. INDICATORS OF IMPENDING DEFAULT. In order to expeditiously and effectively resolve project problems and prevent defaults, the Field Office must be aware of the scope and type of each problem at the earliest possible stage. Projects having physical, financial, or management problems could be an indication that a default is impending. Indicators that suggest a potential default may exist are as follows:

A. HIGH OR INCREASING VACANCY RATE.

B. PERSISTENT PHYSICAL PROBLEMS of a serious nature (such as health and safety problems, security problems, deferred maintenance, etc.).

C. UNAUTHORIZED DISTRIBUTIONS, as defined in HUD Handbook 4370.2, Financial operations and Accounting Procedures for Insured Multifamily Projects, or unauthorized diversion of project assets.

D. ANNUAL OR MONTHLY EXPENSES exceed income potential and will more than likely continue.

E. PROJECT EXPENSES ARE ABNORMALLY HIGH OR LOW compared to previous years or comparable projects.

F. PROJECT RENTS THAT ARE ABNORMALLY LOW.

G. PROJECT RENTS IN EXCESS OF AUTHORIZED LIMITS.

H. BANKRUPTCY has been declared or threatened by the owner/sponsor.

I. RESERVE FOR REPLACEMENT FUNDS have been requested more than once to pay for the mortgage, fuel, utilities, insurance, security or for routine expenses for which the account was never intended.

J. BELOW SATISFACTORY RATING on the Management Review Report or Annual Physical Inspection Report.

K. ANNUAL FINANCIAL STATEMENTS DISCLOSE SIGNIFICANT IRREGULARITIES, such as qualified auditor's opinions; negative cash throw-offs; line items that are inconsistent with each other, with the prior years, or with similar projects; under-funded reserve and escrow accounts; increasing accounts payables, receivables, or bad debts.

L. ANNUAL FINANCIAL STATEMENTS ARE NOT SUBMITTED within 60 days after close of project fiscal year.

M. REQUIRED MONTHLY ACCOUNTING REPORTS ARE NOT SUBMITTED to the Field Office in a timely manner, or are submitted only sporadically.

N. SECTION 8 UNITS THAT DO NOT MEET HOUSING QUALITY STANDARDS (HOS) and project funds are not available to immediately correct the deficiencies.

O. OWNER HAS ABANDONED OR HAS THREATENED TO ABANDON THE PROJECT.

P. COMMERCIAL SPACE IS UNRENTABLE or is being rented at uneconomic rents, causing a cash drain on the project, or commercial space detracts from project liveability.

5-5. PREVENTIVE ACTION. If any of the above conditions, or those determined by the Field Office to denote an impending default, exists at a project, the Field Office must determine, either through meetings or discussions with the mortgagor, whether a plan of corrective action is necessary. Corrective and preventive action may include, but is not limited to:

A. SURVEY/ANALYSIS OF THE LOCAL MARKET AREA could determine if high vacancies are due to market demand, failure of the mortgagor to provide services and facilities found in competitive rental properties, or failure of the mortgagor to aggressively and adequately market vacant units. If the project is experiencing high or increasing vacancy rates, the Field Office should ensure that:

1. The owner's policy for marketing vacant units is sufficient to attract eligible applicants.

2. Adequate project income is available for the owner to provide services and facilities equal or comparable to that provided by similar and competitive projects in the local market area.

3. The owner is adequately maintaining the units and quickly making vacant units available for rent-up. A review of monthly or annual financial statements will indicate whether maintenance expenses appear adequate to properly maintain the property. The annual physical inspection and on-site management review should be used to determine the condition of vacant units and the length of time it takes to make a unit available for rent-up.

B. PHYSICAL INSPECTIONS should be conducted by Field Office staff when it is determined either through the mortgagee's physical inspection, HUD on-site management reviews, or unit inspections that recurring and persistent physical problems exist. Continued deterioration of the project will result in a loss occupancy and eventual default. The Loan Management Branch staff must develop, in accordance with Chapter 6 of this Handbook, a plan of action to correct physical deficiencies and restore the project to physical health.

C. REVIEW FINANCIAL STATEMENTS to ensure that 1) the project is producing sufficient income to cover operating expenses and funding of reserves and 2) unauthorized distributions have not been taken. Monthly and annual financial statements must be reviewed in accordance with HIM Handbook 4370.1, Reviewing Annual and Monthly Financial Reports.

1. If the project has a high occupancy rate and the results of the review indicate that there is a negative net cash throw-off or that project income is not sufficient to cover expenses, Loan Management staff must determine the cause, e.g., if this is due to unexpected increases in operating expenses (such as taxes, insurance, etc.), excessive management fees, or rental rates below the HUD approved schedule. The Loan Management staff must work with the owner to develop a plan to correct any deficiencies discovered in the financial operation of the project, including, but not limited to:

a. approving a rent increase,

b. requiring the management agent to return amounts in excess of approved management fee, or

c. temporarily suspending payments to the Reserve for Replacement Fund, etc.

2. A distribution of funds other than that which is authorized by the Regulatory Agreement could contribute to a deteriorating financial condition of the project, which could subsequently result in default. If the Loan Management staff discovers there has been an unauthorized distribution, the owner must be required to return any and all funds to the project within thirty (30) days or such period of time as determined by the Field Office. The Loan Management Branch staff should advise the mortgagor that if repayment is not made, HUD will take all possible action to recover the unauthorized distribution.

D. ANALYSIS OF DISTRESSED OR TROUBLED PROJECT. The Field Office Loan Management Branch staff should use Form HUD-9815, Project Analysis Worksheet, (Appendix 1) to assist in servicing projects with problems that could result in default. This Form should be completed, and updated as determined by the Field Office, when any of the following takes place:

1. Receipt of a Notice of Default Status Report on Multifamily Housing Projects (Form HUD-92426) or a Delinquency Notice from Regional Accounting Division (RAD) for Section 202 projects.

a. Upon receipt of a Form HUD-92426 from a mortgagee on an insured project or from a coinsuring lender on a coinsured project, the Field Office must acknowledge receipt of the form and return one copy to the coinsuring lender.

b. Upon receipt of an Election to Acquire or a withdrawal of an Election to

Acquire from a coinsuring lender, the Office of Multifamily Housing, Coinsurance Management Division, will acknowledge receipt of the form and return one copy to the coinsuring lender.

C. Upon receipt of an Election to Assign or a withdrawal of an Election to Assign, the Office of Multifamily Housing, Operations Division, will acknowledge receipt of the form and return one copy to the mortgagee.

2. A request for a deferment of principal payments and modification of the mortgage.

3. A request for suspension of payments to the Reserve for Replacement account, unless there are adequate reserves as determined by the Loan Management Branch Chief.

4. A recommendation for forbearance of principal and interest.

5. Upon receipt of the mortgagee's notice electing to assign or foreclose the mortgage.

6. Loan Management staff declares project troubled.

7. Financial and/or management difficulties that the Field Office determines warrants such an analysis.

8. Persistent, validated tenant complaints of a serious nature, including, but not limited to harassment, leasing irregularities, improper certification, discrimination, or fraud by the project management or owner.

9. Major code violations.

10. Major violations of the Regulatory Agreement.

11. Request for Flexible Subsidy funds.

12. Request for Loan Management Set-Aside funds.