

Prepayment of Mortgage Under Bankruptcy Reorg. Plan

Legal Opinion: GHM-0031

Index: 3.346, 3.296

Subject: Prepayment of Mortgage Under Bankruptcy Reorg. Plan

April 6, 1992

Ruth Westmont, Esq.
Wisconsin Housing and Economic
Development Authority
1 South Pinckney St., Suite 500
Madison, Wisconsin 53701-1728

Dear Ms. Westmont:

This is in response to your letter of March 27, 1992 to Lewis Nixon, Regional Counsel in Chicago. You requested the opinion of the United States Department of Housing and Urban Development ("Department") on the proposal of the owner of Kenwood Apartments to prepay its mortgage as part of its bankruptcy reorganization plan.

Kenwood Apartments (the "Project") is subject to a mortgage, dated May 7, 1974, which is insured by the Wisconsin Housing and Economic Development Authority ("WHEDA"). As a condition of receiving mortgage insurance, the owner, Kenwood Apartments Partnership (the "Partnership"), has executed a Regulatory Agreement, of the same date, requiring that the Project be maintained as low income rental housing until the maturity date of the mortgage, June 1, 2015. The Project currently receives Rental Assistance Payments from the Department and is the subject of an Interest Reduction Payments Contract entered into between HUD and WHEDA. The Rental Assistance Contract and the Interest Reduction Payments Contract require that the Project be used as low income rental housing for the term of the mortgage. Both the Rental Assistance Contract and the Interest Reduction Payments Contract terminate upon the maturity of the mortgage or when the mortgage is paid in full, whichever occurs first.

Pursuant to the terms of the mortgage, the Partnership may not prepay the mortgage within the first twenty years from the date of the first mortgage payment without the consent of WHEDA. Eighteen years from the date of the first mortgage payment, June 1, 1994, the Project will become subject to the terms of Subtitle A of Title VI of the National Affordable Housing Act, the Low Income Housing Preservation and Resident Homeownership Act of 1990 ("LIHPRHA"). LIHPRHA precludes prepayment of the Project's mortgage from the twentieth year of the mortgage until its maturity date unless the owner has a HUD-approved plan of action. Congress enacted LIHPRHA in response to the risk of losing viable low income housing projects due to owners prepaying their

mortgages and converting low income housing to more profitable uses. LIHPRHA creates a permanent and comprehensive incentive program to preserve privately owned low income housing projects

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and minimize the displacement of current tenants from these projects.

A prepayment of the Project's mortgage, as proposed by the Partnership in its reorganization plan, would have the effect of terminating all low income use restrictions on the Project. Rental Assistance Payments and Interest Reduction Payments would also terminate at the time of prepayment. The prepayment would effectively result in the Project being lost from the country's low income housing inventory and could cause the current tenants of the Project to lose their homes.

This type of prepayment would circumvent the intent of Congress by allowing an owner to prepay its mortgage without the Department's approval and without being subject to the statutory requirements of LIHPRHA, including those which would protect the tenants of the Project if the use restrictions are terminated. Permitting the Partnership to go ahead with its plan to prepay the mortgage through a bankruptcy proceeding and to refinance the Project without any low income use restrictions would create a dangerous precedent for other owners who may be searching for a means of circumventing LIHPRHA. Based on these grounds, the Department strongly objects to the Partnership's prepayment proposal.

If you have any further questions or require additional information regarding this matter, please contact me at 202-708-2495.

Very sincerely yours,

Frank Malone
Director
Office of Preservation and
Property Disposition

cc:
Nixon
Yochim