



U.S. Department of Housing and Urban Development
Office of Housing

Special Attention of:

Regional Directors, Field Office
Directors, Multifamily Hub
Directors, Multifamily Program
Center Directors, Housing Project
Managers, Section 202 Owners and
Management Agents

Notice H 2002-16 (HUD)

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Cross References: Supersedes H 99-06 and H 00-26

Subject: Revised Prepayment of Direct Loans on Section 202 and 202/8 Projects with Inclusion of FHA Mortgage Insurance Guidelines

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I. PURPOSE.

This Notice supersedes Notice H 00-26, provides guidance for Multifamily Hub/Program Center (Hub/PC) staff and Owners of Section 202 Direct Loan projects on prepayment and refinancing of Section 202 Direct Loans projects and Section 202 Direct Loans with project-based Section 8 Rental Assistance (Section 202/8 projects). It sets forth the requirements for a narrowly defined Limited Partnership ownership entity that may acquire and operate the project after prepayment. It authorizes Hub Directors to approve prepayment proposals. It also includes underwriting guidelines where an Owner or prospective Owner is proposing to use FHA mortgage insurance to refinance the Section 202 Direct Loan.

II. AUTHORITY.

Authority for the prepayment of a Section 202 or 202/8 Direct Loan is provided by Section 811 of the American Homeownership and Economic Opportunity (AHEO) Act of 2000 and 24 CFR 891.530. Section 612(h) of the Departments of Labor, Health and Human Services, and Education Appropriations Act, for the fiscal year ending September 30, 2002 amended the MAHRA statute to exempt Section 202 or 202/8 projects refinanced with FHA insurance **and processed under the requirements of this Notice** from MAHRA restructuring and market rent comparability requirements. Authority for refinancing using FHA Mortgage Insurance is provided in the National Housing Act (NHA), as amended. Section 811 also identified the Risk Sharing Program under Section 542, as a refinancing resource.

Pursuant to authority under Section 612(h) of the Departments of Labor, Health and Human Services, and Education Appropriations Act ending September 30, 2002, projects refinancing their Section 202/8 Direct Loans with FHA insurance are exempt from MAHRA restructurings and market comparability requirements **if** the prepayments and refinancings are processed under the requirements of Section 811 of the AHEO Act and this Notice.

Specifically, Section 811 permits a prepayment and refinancing of a Section 202 or 202/8 Direct Loan if (1) the project sponsor agrees to operate the project until the maturity date of the original loan under terms at least as advantageous to existing and future tenants as the terms required by the original loan agreement or any rental assistance payments contract under Section 8, including rent supplement program, related to the project and (2) the prepayment may involve refinancing of the loan if such refinancing results in a lower interest rate on the

principal of the loan for the project and in reductions in the debt service related to such loan.

III. GENERAL INFORMATION/BACKGROUND.

There is **no** requirement that a refinancing plan for a Section 202 or 202/8 Direct Loan include FHA mortgage insurance. Direct Loans may be refinanced using any third party source, including financing by State or local housing finance agencies, use of tax-exempt bonds, multifamily mortgage insurance under the National Housing Act, reinsurance, or other credit enhancements, including risk sharing as provided under section 542 of the Housing and Community Development Act of 1992.

IV. PREPAYMENT ACTIONS.

There are two types of prepayments:

A. Prepayments which **do not require** HUD's approval.

1. Section 202 projects approved during approximately 1977 to 1982 have a mortgage note that permits the prepayment with only a 30-day notice to HUD. Typically, the mortgage note, Form FHA-3432-EH (6/76) contains language similar to the following:

"Privilege is reserved to pay the debt in whole or an amount equal to one or more monthly payments on principal next due, on the first day of any month prior to maturity, upon at least thirty (30) days prior written notice to the Payee."

2. The Owner can pay off its 202 mortgage upon a 30-day written notice submitted to the Hub/PC and the residents.
3. Where an Owner may prepay a Direct Loan without HUD's approval, but where the Owner elects to process the prepayment and refinancing under the terms of this Notice, HUD may permit the project to remain exempt from MAHRA requirements and, if approved in the prepayment/refinancing proposal, keep its current Section 8 rent levels, **if** the Owner/project agrees to prepay and refinance under the terms of this Notice and the project owner executes and records the Section 202 Use Agreement required under this Notice.

4. The Hub Director may approve the prepayment proposal where HUD's permission to prepay is not required, **however, the Headquarters' Office of Asset Management must provide the Hub Director written approval to prepay a Section 202 Direct Loan under the Headquarters' "Prepayment Checklist" process.**

B. Prepayments which **require** HUD's approval.

1. Any prepayment action/request where the Direct Loan Note does not explicitly grant a right to prepay the loan, or the Owner elects to proceed under the Notice rather than to exercise its right to prepay.
2. Where HUD approval is required to prepay a Direct Loan, the Use Agreement prescribed in Attachment 4 must be executed by the Owner and HUD and recorded upon HUD approval of the prepayment transaction.
3. Hub Directors are authorized to approve prepayment proposals that are processed under the requirements of this Notice and where the project will receive and record the Use Restrictions under the requirements of this Notice. **However, the Headquarters' Office of Asset Management must provide the Hub Director written approval to prepay a Section 202 Direct Loan under the Headquarters' "Prepayment Checklist" process.**

V. ACCEPTABLE PROJECT OWNERSHIP.

A. A project that requires HUD permission to prepay, and therefore will be under a HUD Section 202 Use Agreement (see Attachment 4) until the maturity date of the Section 202 Direct Loan, may refinance the transaction with the following types of ownership:

1. The project must be owned and maintained by the current ownership entity, or
2. The project may be owned by a For-Profit Limited Partnership the sole general partner of which is the current project owner or a corporation wholly owned and controlled by the current owner.
3. The current project owner, in conjunction with the processing of a prepayment under this Notice, may transfer the project to an acceptable and experienced non-profit elderly housing provider eligible as an owner under section 202(k)(3) and

(k) (4) of the Housing Act of 1959 as amended by section 831 of the American Homeownership and Economic Opportunity Act of 2000 and in accordance with the Department's transfer of physical assets (TPA) procedures.

- B. All entities, either existing owners or new participants from the ownerships described above, must have HUD's Previous Participation Clearance (HUD 2530) approval prior to an approval of a prepayment proposal under this Notice.

VI. USE OF PROJECT-BASED SECTION 8 CONTRACT SAVINGS.

- A. Upon approval of the refinancing of a project under this Notice and recordation of the Section 202 Use Agreement, the Secretary shall make available at least 50 percent of the annual savings resulting from reduced Section 8 or other rental housing assistance contracts in a manner that is advantageous to the tenants, including:
1. not more than 15 percent of the cost of increasing the availability or provision of supportive services, which may include the financing of service coordinators and congregate services,
 2. rehabilitation, modernization, or retrofitting of structures, common areas, or individual dwelling units,
 3. construction of an addition or other facility in the project, including assisted living facilities (or, upon the approval of the Secretary, facilities located in the community where the project sponsor refinances a project under this Notice, or pools shared resources from more than one such project),
 4. rent reduction of unassisted tenants residing in the project according to a pro rata allocation of shared savings resulting from the refinancing.
- B. At the time of prepayment processing, the existing project-based Section 8 Contract rents **will not be increased.**
- C. Renewal of a project-based Section 8 Contract.
1. If the prepayment transaction occurs during the term of a project-based HAP Contract, the project may keep its existing rents if the prepayment proposal provides justification, within the terms of this Notice, to use

all of the existing rents and HUD approves the prepayment proposal.

2. Upon termination of the Project-Based Section 8 HAP, the contract renewal procedures set forth in the Section 8 Renewal Guide must be followed. As stated in Chapter Six of the Guide, exception projects are renewed initially at the lesser of current rents adjusted by an Operating Cost Adjustment Factor (OCAF) or a budget-based rent adjustment. Future adjustments are by OCAF or, upon request of the owner and subject to approval by the Secretary, on a budget basis. No additional "lesser of" test is required.

VII. SUBSIDY LAYERING REVIEW.

If the prepayment proposal contemplates the use of more than one government subsidy as a source of funds (i.e., Sec. 8 assistance, FHA mortgage insurance, Rent Supplement, Low Income Housing Tax Credits (LIHTC), HOME Funds, CDBG funds, other State or local government funds), the proposal **must have** a Subsidy Layering Review completed before the prepayment proposal may be approved.

VIII. USE OF CERTAIN PROJECT FUNDS.

- A. The Secretary shall allow a project sponsor that is prepaying and refinancing a project under this Notice to:
 1. use any Residual Receipts held for the project in excess of \$500 per individual dwelling unit for not more than 15 percent of the cost of activities designed to increase the availability or provision of supportive services, and
 2. use any Reserve for Replacement in excess of \$1,000 per individual unit for activities to:
 - a. rehabilitation, modernization, or retrofitting of structures, common areas, or individual dwelling units,
 - b. construction of an addition or other facility in the project, including assisted living facilities (or, upon the approval of the Secretary, facilities located in the community where the project sponsor refinances a project under this Notice, or pools shared resources from more than one such project).

B. Other limitations on the use of project funds:

1. If LIHTC are used as a source of equity and to assure that the greatest amount of tax credit equity will be used for construction purposes, the following limitation applies:
 - a. a maximum developer's fee of 9 percent of the acceptable development costs for developer fee calculation under a State's LIHTC program.
2. Maximum annual distribution from project income.
 - a. The maximum annual distribution from surplus cash that may be taken is 6 percent of the owner's equity that was paid at the refinancing of the project. Funds provided from LIHTC equity, other government funds (i.e., HOME Funds, CDBG funds, etc.) **will not** be considered owner's equity.

IX. TENANT NOTIFICATION.

- A. At least 30 days before submitting a prepayment request to HUD, the Owner must notify the tenants of its intention to prepay. If HUD's permission to prepay is needed, then the notice must also address how the prepayment is advantageous to the tenants. If a project, that has the right to prepay without HUD's permission, elects to prepay under the requirements of this Notice, then the project must comply with **all** the processing requirements set forth in this Notice, including but not limited to the recording of the Use Agreement contained in the Notice. See Section XI below.
- B. The notice must be delivered directly to each unit in the project or mailed to each tenant and posted in 3 places/ common areas throughout the project, including the project office.

Note: In a project greater than 4 stories in height, the notice may be served either by delivery or by posting. If the posting method is used, the notice must be posted in at least three conspicuous places within each building in which the affected dwelling units are located.

1. The tenants (including any legal or other representatives acting for the tenants individually or as a group) have the right to inspect and copy the materials that the Owner is required to submit to HUD

for a period of 30 days from the date on which the notice is served to the tenants. Any tenant comments must be available in the project office during normal business hours for public reading and copying.

2. The tenants have the right, during this period, to submit written comments on the proposed prepayment to the Owner and the local HUD Office. Tenant representatives may assist tenants in preparing these comments.
- C. Upon completion of the tenant comment period, the Owner must review the comments submitted by the tenants and their representatives and prepare a written evaluation of the comments. Any negative comments must be addressed in the request for prepayment. The Owner must then submit the following materials to the local HUD Office:
1. Copies of all the tenant comments;
 2. The Owner's evaluation of the tenant comments; and
 3. A certification by the Owner that it has complied with all of the requirements of 24 CFR 245.410, 245.415, 245.416 through 245.419, as applicable, and 245.420.

X. BENEFITS TO THE RESIDENTS OF THE PREPAYMENT.

- A. Where HUD's approval of the prepayment is required, or where a prepayment proposal is being process under this notice, the Owner must submit a plan that demonstrates how the prepayment is at least as advantageous to the existing and future tenants as the terms required by the original loan agreement or any rental assistance and such plan shall describe how any use of savings in rental assistance or refinancing of the project's debt will be used for the following:
1. increasing the availability or provision of supportive services, which may include the financing of service coordinators and congregate services;
 2. rehabilitation, modernization, or retrofitting of structures, common areas, or individual dwelling units;
 3. construction of an addition or other facility in the project, including assisted living facilities (or, upon the approval of the Secretary, facilities located in the community where the project sponsor refinances a project under this Notice or pools shared resources from more than

one such project); or

4. rent reduction of unassisted tenants residing in the project according to a pro rata allocation of shared savings resulting from the refinancing.
5. Compliance with Section 504 requirements, where applicable.

XI. USE AGREEMENT IS REQUIRED WHERE HUD MUST APPROVE THE PREPAYMENT REQUEST.

- A. Attachment 4 is the Use Agreement that will be used under this Notice.
- B. The attached Use Agreement, or other recordable document that will control the use of the project upon the prepayment of the Section 202 or 202/8 Direct Loan, following the standard Use Agreement language in Attachment 4, must be included in the Owner's prepayment submission to HUD for consideration.
- C. After Hub Director's approval of the prepayment proposal to prepay the Section 202 Direct Loan, following Headquarters' approval of the Direct Loan prepayment pursuant to the "Prepayment Checklist", the Owner and HUD execute the Use Agreement.
 1. The Owner must have the Use Agreement recorded in a superior position to any financing and the Owner must provide evidence of recordation to the Hub/PC at or before prepayment.
 2. The Use Agreement runs with the land and binds all subsequent Owners and creditors until the date that the original Section 202 Direct Loan would have reached maturity.

XII. PREPAYMENT OF EXISTING FLEXIBLE SUBSIDY/HELP LOANS.

- A. If a 202 project has a Flexible Subsidy loan or a HELP loan, these loans must be repaid at the same time the 202 Direct Loan is prepaid. Any Use Agreement imposed from the use of Flexible Subsidy funds shall remain in effect.

XIII. CONTINUATION OF RENT SUPPLEMENT CONTRACT.

- A. If a Section 202 project has a Rent Supplement Contract, the contract would normally terminate upon prepayment of the Direct Loan. If a Section 202 project prepays and

refinances under the terms of this Notice and the Use Agreement contained in this Notice is recorded at the time of the prepayment, then the Rent Supplement Contract may continue to the original maturity date of the Section 202 Direct Loan or the expiration date of the Rent Supplement Contract, whichever is earlier. To continue the Rent Supplement Contract after the repayment of the 202 Direct Loan, a waiver of 24CFR215.35 must be granted by Headquarters.

XIV. PREPAYMENT CONSULTATION WITH HUB/PC STAFF.

- A. An Owner considering prepayment should consult with its Housing Project Manager in the appropriate Hub/PC before proceeding. This meeting should cover at least the following:
1. Whether or not the Section 202 Direct Loan can be prepaid without HUD approval.
 2. Tenant notification requirements.
 3. The terms and conditions of the Use Agreement, if applicable.
 4. Section 8 Contract issues resulting from prepayment.
 5. "Advantage to the tenants" requirement.
 6. Payment due for an outstanding Flexible Subsidy loan, or other HUD debt, if appropriate, and the continuation of the Flexible Subsidy, or other, Use Agreement(s).
 7. If applicable, the procedures for terminating Rent Supplement contract and obtaining Regular Vouchers for the affected households living in Rent Supplement assisted units, if applicable.
 8. Disposition of replacement reserves and residual receipts, if applicable.
 9. The type of refinancing, other subsidies, use of LIHTC, etc.

XV. APPLICATION TO PREPAY THE DIRECT LOAN.

The Owner submits:

- A. A written request to the appropriate Hub/PC (use format in Attachment 1)
- B. A copy of:
1. The mortgage and mortgage note;
 2. Housing Assistance Payment Contract;
 3. Regulatory Agreement;
 4. All tenant comments and the Owner's written evaluation of the comments

5. Any other use agreements/restrictions, subordinate mortgages/loans that may be in place.
- C. List of households currently residing in Section 8 or Rent Supplement assisted units.
- D. List of any commercial renters/leases, vendors that may be in place.
- E. If applicable, statement regarding application for FHA mortgage insurance or Risk Sharing Program.
- F. Additional documents if HUD must approve the prepayment.
 1. A detailed narrative explaining why the proposal is advantageous to the tenants.
 2. A detailed narrative justifying the future use of the full rental assistance currently being provided to the project.
 3. Draft copy of the Use Agreement which will be recorded at the time of prepayment.

XVI. MULTIFAMILY HOUSING HUB/PROGRAM CENTER RESPONSIBILITIES.

- A. Multifamily Hubs and Program Centers must process any Section 202 prepayment request within 30 days of receipt (or within appropriate timeframes if the transaction involves FHA mortgage insurance). **Hub Directors** are authorized to approve acceptable prepayment proposals, **if**, Hub Directors have obtained written approval from Headquarters to prepay the Section 202 Direct Loan, i.e., "Prepayment Checklist Approval".

For prepayments which **do not require** HUD's approval, use the checklist at Attachment 2 as guide.

 1. Verify that all tenant notification procedures have been followed.
 2. Verify the "right to prepay" language in the mortgage note with the Office of General Counsel.
 3. Contact the Ft. Worth Accounting Center to determine the correct payoff amounts for the Direct Loan and the Flexible Subsidy/HELP Loan(s), if applicable.
 4. Notify the Owner of the payoff date and amount for the Section 202 Direct Loan and the Flexible Subsidy/HELP Loan(s), if applicable.

5. **Unless** the project has been processed for prepayment under the terms of this Notice and agrees to accept and record the Use Agreement contained in this Notice, the field office shall take the necessary actions to terminate the Rent Supplement Contract and obtain Regular Vouchers for the eligible families that occupy Rent Supplement assisted units. If the Rent Supplement subsidy is to continue after the prepayment of the 202 Direct Loan, a waiver of 24CFR215.35 must be obtained from Headquarters.

B. For prepayments which **require** HUD's approval.

1. Review the Prepayment submission as outlined in Attachment 1 by using the checklist at Attachment 2 as a guide.
 - a. Verify that all tenant notification procedures have been followed.
 - b. Review any comments received from the tenants.
 - c. Determine that adequate justification and documentation is provided to demonstrate the transaction is "advantageous to the tenants."
 - d. Check records to see if there is an outstanding Flexible Subsidy loan or HELP loan, and/or Use Agreement(s), or other financing. If so, the Flexible Subsidy Loan and/or HELP Loan is due and payable as part of the prepayment.
 - e. Prepare an analysis of the prepayment proposal and approve acceptable proposals:
 - 1) An analysis of the tenant comments and Owner's evaluation of said comments.
 - 2) An analysis of the prepayment proposal's proposed use of the rental assistance currently provided the project and the sponsor's justification for the future use of the full subsidy based on the prepayment proposal.
 - 3) A brief description of the basis for the approval or rejection of the Owner's prepayment proposal.
 - f. If the use of FHA mortgage insurance or Risk Sharing Program for refinancing purposes is requested as part of the prepayment process, proceed with the

underwriting requirements in Section XVII below.

2. Field Office will complete the "Field Office Checklist for Prepayment" form and submit it to the appropriate Desk Office in the Headquarters Office of Asset Management for review and approval.
3. The Headquarters Office of Asset Management will approve or reject Hub prepayment requests to prepay Section 202 Direct Loans based on its review and processing of the "Prepayment Checklist."

C. Final Processing.

1. Contact the Ft. Worth Accounting Center to determine the correct payoff amounts for the Direct Loan and the Flexible Subsidy/HELP Loan(s), if applicable.
2. Notify the Owner of:
 - a. Hub Director's approval of the prepayment request, using Attachment 3 as a guide. The approval letter shall reference the final prepayment proposal that was agreed to by HUD and the project sponsor/owner.
 - b. The payoff date and amount for the Section 202 Direct Loan and, if applicable, the Flexible Subsidy or HELP Loan(s).
 - c. Request evidence for the recordation of the Use Agreement.

XVII. FHA MORTGAGE INSURANCE AND RISK-SHARING PROCESSING.

- A. HUD's FHA multifamily mortgage insurance programs and risk-sharing programs under Section 542 of the Housing and Community Development Act of 1992 may be used to facilitate the prepayment/refinancing of the Section 202 or 202/8 Direct Loans. The project sponsor and a HUD approved multifamily lender or Housing Finance Authority (HFA) or Qualified Participating Entity may submit the application for mortgage insurance or request for Risk-Sharing Firm Approval Letter or Risk-sharing Addendum at the same time a request for prepayment proposal is submitted to the Hub or Program Center. However, the prepayment review criteria require specific actions and commitments from the sponsor to give HUD good cause to permit the prepayment of a Section 202 Direct Loan requiring HUD's approval to prepay. Therefore, it is strongly recommended that the sponsor of the prepayment request either discuss the proposed

prepayment with the local Hub/program center and/or have the prepayment proposal approved before the lender submits a formal FHA mortgage insurance application with commensurate fees, or before the qualified participating entity or HFA submits the Risk-Sharing Request.

1. A TRANSACTION WITH PROJECT-BASED SECTION 8 OR OTHER PROJECT-BASED RENTAL SUBSIDIES:

a. The rents used in FHA mortgage insurance processing will be the lesser of:

1. Comparable unassisted market rents; or
2. Current Section 8 Contract rents or unit rents being collected under other project-based rental assistance agreements.

2. FOR FHA MORTGAGE INSURANCE PROGRAM LOANS, THE APPRAISED VALUE, IF APPLICABLE, AND THE MORTGAGE AMOUNT MUST BE BASED ON THE ABOVE RENTAL ANALYSIS, NOT:

- a. Section 8 or rent subsidized projects; or
- b. Upscale retirement service centers with amenity packages included in the rent; or
- c. Projects with up-front entrance or founders fees or life-care fees.

Note: Rent analyses performed under the current Section 8 rent comparability guidelines have no bearing on FHA mortgage insurance processing. FHA staff must follow outstanding MAP or TAP appraisal and underwriting instructions.

3. THE SECTION 542 MORTGAGE AMOUNT MUST BE BASED ON THE LOWER OF:

- a. Current project-based Section 8 contract unit rents or unit rents under rental agreements for other rental subsidies for the project; or
- b. Comparable unassisted market rents.

4. Section VIII of this Notice "Use of Certain Project Funds" provides guidance regarding the treatment of existing residual receipts and replacement reserve accounts. The initial deposit and ongoing replacement reserve for the FHA insured mortgages must still be established in accordance with outstanding underwriting

instructions. Risk-sharing entities must follow their established underwriting procedures under Section 542.

XVIII. FURTHER INFORMATION.

No portion of this Notice may be waived by any Hub/PC Director.

For good cause, waivers of this Notice may be granted by the Office of Multifamily Asset Management.

For further information, call either:

1. Your Desk Officer in the Office of Asset Management at (202) 708-3730.
2. Project managers/owners should contact the Housing Project Manager in the Hub/PC responsible for their project.

Attachments

John C. Weicher
Assistant Secretary for Housing-
Federal Housing Commissioner