



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Special Attention of:

All Multifamily Hub Directors
All Multifamily Program Center Directors
All Multifamily Operation Officers
All Multifamily Directors of Project Management
All Multifamily Field Counsel

Notice H 2010-14

Issued: July 27, 2010

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Cross References:

Subject: Policy and Procedure for Prepayment and Refinancing of Section 202 Projects Funded prior to 1975

A. Purpose

This Notice provides guidance for prepayments and refinancing of Section 202 Direct Loan projects funded prior to 1975 to help preserve elderly housing. These are the oldest projects in the Section 202 portfolio and as such, many if not most, are in need of rehabilitation and renovation. This Notice applies to those Section 202 projects funded between 1959 and 1974 only. These projects can be identified by their "SH" project numbers.

This guidance is for Multifamily Hub/Program Center (Hub/PC) staff and Owners of those Section 202 Direct Loan projects. This Notice complements Notices, H 02-16 and H 04-21 which provides guidance for similar such actions for Section 202 projects funded through direct loans after 1974. Those Notices may be consulted for general guidance on Section 202 prepayment and refinancing. However, where there are conflicts between this guidance and others, this guidance rules for the "SH" projects.

B. Authority

General authority for the prepayment of a Section 202 mortgage is provided by Section 811 of the American Homeownership and Economic Opportunity (AHEO) Act of 2000 and 24 CFR 891.530. However, that statute requires that in a refinancing, there must be a reduction in interest rate and debt service saving from that reduction. With the earliest Section 202 mortgages having interest rates of approximately (3) three percent that is unlikely even in times of historically low interest rates.

To address that issue, Congress enacted Section 234 of the Omnibus Appropriations Act for the Fiscal Year Ending September 30, 2009. Section 234 extends the authority for prepayment and refinancing to the old, low-interest Section 202 mortgages funded prior

to 1975. The statute sets certain conditions for such prepayments and refinancing. Those conditions are detailed below. (See Attachment 1 for the authorities including Section 234).

C. Background

The Section 202 Supportive Housing for the Elderly program is the only Department of Housing and Urban Development (HUD) program that provides housing exclusively for elderly households. The program has changed several times since its inception. During the nearly 50 years that the Section 202 program has existed, the system of providing financing for developments has changed from loans to grants, the tenant population targeted has moved from moderate-income elderly households to very low-income elderly households, and the program has gone from serving only elderly households to serving elderly and disabled households, and then back to serving elderly households exclusively. The history of Section 202 is important because projects developed in the early years of the program continue to operate under the rules in place at the time they were built.

This Notice addresses the projects developed from 1959 to 1974. In that period, the program provided housing units affordable to moderate-income elderly and disabled families by extending low-interest construction loans to nonprofit developers. When the Section 202 program was established in 1959, its purpose was to provide housing for moderate-income elderly tenants—those with too much income for public housing, but insufficient income for market-rate housing.

Through the program, HUD loaned funds to private nonprofit developers so that they could build housing for elderly families and individuals. The interest rate on the loans were low—approximately (3) three percent—and had a term of up to 50 years. More than 45,000 units in 335 projects were built during the period from 1959 to 1974. Individual projects for older persons were relatively large, averaging 153 units. Most of the units were efficiency apartments, and the projects tended to be located in large cities. The combination of the financing of these projects and the age of the buildings give the oldest Section 202 projects a unique profile. These moderate-income facilities house the oldest and frailest residents. Consistent with agreements signed when the Section 202 financing was awarded, moderate income eligibility is retained in these facilities, and the average resident income remains the highest among all phases of the program. These higher incomes allow managers of the pre-1975 projects better short-term rental income flexibility than facilities built in the later lower-income phases. The developers, assisted by low-interest mortgage payments, could set rents in their buildings at levels that were affordable to elderly households with moderate incomes.

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At the program's inception in 1959, there were no income eligibility restrictions for occupants, or control of rents. The developers, assisted by low-interest mortgage payments, could set rents in their buildings at levels that were affordable to elderly households with moderate incomes.

But in 1962, HUD began setting rents for Section 202 properties on a community-by-community basis. The new rents were meant to be affordable for lower-middle income elderly households, so they varied across the country. In 1968, HUD set income eligibility limits for occupancy of newly funded Section 202 developments at the higher of 135 percent of public housing limits or 80 percent of area median income. To make units affordable for low-income elderly tenants (those with incomes at or below 80 percent of area median income), Congress enacted a rental subsidy program called Rent Supplement as part of the Housing and Urban Development Act of 1965 (P.L. 89-117). However, tenants receiving rent subsidies made up a relatively small percentage of total tenants during the early years of the Section 202 program.

The eligible tenant population for the Section 202 program changed in 1964 when non-elderly "handicapped" individuals and families were added to the definition of "elderly families" as part of the Housing Act of 1964 (P.L. 88-560). Yet, very few non-elderly handicapped families participated in the Section 202 program between 1964 and 1974. Although data were not kept, HUD estimates that through 1977, less than (1) one percent of tenants were non-elderly handicapped.

In Fiscal Year 1970, the Section 202 program was not funded for the first time since its enactment. The Nixon Administration did not propose any new funds for the program and Congress did not appropriate them. Between 1970 and 1974, the Section 202 program did not fund any new construction projects.

Of the Section 202 properties funded prior to 1974, there are approximately 242 projects with some 33,000 units that still have active loans. These properties continue to accept tenants according to the rules in place at the time they were developed. Section 202 developments that applied for HUD funds prior to 1962 are not subject to income limits, while those constructed after 1962 but prior to July 1972 are subject to the income limits approved by HUD at the time. In addition, in the years since many pre-1974 Section 202 developments were constructed, HUD has provided rental assistance for approximately 38 percent of the units, primarily through the Loan Management Set Aside (LMSA) program. LMSA was a special allocation of Section 8 project-based assistance contracts available for units in troubled FHA-insured or HUD direct loan properties.

D. Approval of Prepayment of Debt

Section 234 provides that upon request of the project sponsor of a project assisted with a loan under Section 202 of the Housing Act of 1959 (as in effect before the enactment of the Cranston-Gonzalez National Affordable Housing Act), for which the Secretary's consent to prepayment is required, the Secretary shall approve the prepayment of any indebtedness to the Secretary relating to any remaining principal and interest under the loan as part of a prepayment plan under which 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 project-based rental assistance payments contract under Section 8 of the United States Housing Act of 1937 (or any other project-based rental housing assistance programs of the Department of Housing and Urban Development, including the rent supplement program under Section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s)) or any successor project-based rental assistance program, except as provided by subsection (a)(2)(B).

E. Refinancing

Section 234 goes on to provide that the prepayment may involve refinancing of the loan if such refinancing results:

1. In a lower interest rate on the principal of the loan for the project and in reductions in debt service related to such loan. (See Notices H 02-16 and H 04-21 for guidance on these projects.); or
2. In the case of a project that is assisted with a loan under such Section 202 carrying an interest rate of (6) six percent or lower, **(these are projects this Notice applies to)**, a transaction under which:
 - (a) The project owner shall address the physical needs of the project; and
 - (b) The prepayment plan for the transaction, including the refinancing, shall meet a cost benefit analysis, as established by the Secretary, that the benefit of the transaction outweighs the cost of the transaction including any increases in rent charged to unassisted tenants.

F. Physical Needs of the Project

Section 234 requires the owner to address the physical needs of the project. As a matter of policy, the amount of rehabilitation must rise to the level of substantial rehabilitation as defined by the Multifamily Accelerated Processing (MAP) guide. Otherwise, the transaction could have the effect of merely trading low interest debt for higher interest debt. While a Capital Needs Assessment (CNA) would be useful in defining the needs of the project, its cost may not always be justified, so a CNA is not required. Notwithstanding, the owner must assess the repair and rehabilitation needs and document them in its proposal in a manner acceptable to the Hub/PC Director.

The Hub Director may waive the policy requirement for substantial rehabilitation where the project's history shows an active program to maintain and upgrade the project. Any such policy waiver must be documented with a trend, trend analysis, or pattern recognition of the history of the project's physical inspection scores, its use of its replacement reserve and residual receipts, and any supplemental funds used to upgrade the project. Of particular note would be improvements to reduce energy usage, the addition of fire sprinkler systems, and items to improve accessibility and support tenants' aging in place. Additionally, this may include but not be limited to ramps, strategically placed building maps, and accessible hallway phones that may be used when assistance is needed and if there is an emergency.

Where the owner can document difficulties in renting efficiency units, it may propose the conversion of efficiency units into one bedroom units pursuant to the unit conversion policy guidance. (See the current policy and procedures for unit conversions.)

In its plans for repair, rehabilitation and retrofit, the owner must consider the use of "ENERGY STAR" appliances and components.

The proposed rehabilitation shall restore the property to local code and accessibility requirements. It should be noted that if substantial rehabilitation is involved, the rehabilitation must comply with Section 504 of the Rehabilitation Act of 1973. (See 24 CFR Section 8.23).

The owner may consider the addition or rehabilitation of related facilities. The Housing Act of 1959 defined related facilities as:

1. new structures suitable for use as cafeterias or dining halls, community rooms or buildings, or infirmaries or other inpatient or outpatient health facilities or for other essential service facilities; and

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2. structures suitable for the above uses by rehabilitation, alteration, conversion, or improvement of existing structures which are otherwise inadequate for such uses. Rehabilitation plans should be developed with consideration for the purpose of extending the utility of the project for frail elderly. Congress clearly intends for the program to provide a continuum of care that includes appropriate support needed by frail elders to maintain independent living. The Cranston-Gonzalez National Affordable Housing Act of 1990 adds clarity to the description of the purpose of the Section 202 program stating: to enable elderly persons to live with dignity and independence by expanding the supply of affordable housing that (1.) is designed to accommodate the special needs of elderly persons; and (2.) provides a range of supportive services that are tailored to the needs of elderly persons occupying such housing.

G. Relocation

Because of the requirement that the level of rehabilitation meet HUD's definition of substantial rehabilitation, the proposal may require the temporary relocation of tenants for the period of rehabilitation. To permit rehabilitation to proceed, an owner may temporarily relocate a tenant or, permanently relocate a tenant within the same building or complex. Section 202 projects are subject to the relocation requirements at 24 CFR 891.155(e). However, there may be no permanent displacement of any tenant as a result of the proposed transaction. For tenants that must relocate, the owner must provide:

1. Reimbursement for all reasonable out-of-pocket expenses incurred in connection with the temporary relocation, including the cost of moving to and from the temporarily occupied housing and any increase in monthly rent or utility costs.
2. Appropriate advisory services, including reasonable advance written notice of:
 - (a) The date and approximate duration of the temporary relocation;
 - (b) The suitable, decent, safe, and sanitary housing to be made available for the temporary period;
 - (c) The terms and conditions under which the tenant may lease and occupy a suitable, decent, safe, and sanitary dwelling in the building/complex following completion of the repairs; and

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- (d) The right to the financial assistance described in paragraph 1 above.
- 3. All other conditions of the temporary relocation that the tenant undergoes must be reasonable.
- 4. Permanent move within building/complex. A tenant who is required to move to another unit in the same building/complex must be offered reimbursement for all out-of-pocket expenses incurred in connection with the move. All other conditions of the relocation that the tenant undergoes must be reasonable. Relocating an elderly person with a disability requires locating a unit that is appropriate to their physical needs. A temporary relocation must be to an accessible unit that provides equal or greater accessibility as the current unit.
- 5. It should be understood that a relocated tenant will be given the first right of refusal to the rehabilitated unit. Further, the notification to tenants should be provided in appropriate formats as necessary to meet the needs of all including persons with limited English proficiency and formats for persons who are visually or hearing impaired.

For the purposes of FHA mortgage insurance, reasonable and necessary relocation costs may be included in the calculation mortgageable costs.

H. Accessibility for Persons with Disabilities

The Section 202 program can offer persons with disabilities, a community-based living alternative to institutionalization. As part of a continuum of care available to those with few resources, it has the potential of providing significant cost savings to the states for the housing and care of elders with disabilities. It is also one option that states can use to comply with *Olmstead v. L.C.* (1999), where the Supreme Court ruled that states may not discriminate against persons with disabilities by refusing to provide community services when these are available and appropriate.

- 1. Section 504 of the Rehabilitation Act of 1973 applies when substantial alterations are made to Section 202 projects. (See 24 CFR Section 8.23).
- 2. Title VIII of the Civil Rights Act of 1968, as amended, commonly known as the Fair Housing Act (the Act) directs the Secretary of HUD to provide technical assistance to states, local governments, and other persons in implementing the accessibility requirements of the Act. Section 804(f)(3)(c) requires that all residential buildings which have four or more units and which are built for first occupancy after March 13, 1991 (referred to in the Act as “covered multifamily dwellings”), be designed and constructed to have at least one building entrance on an

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accessible route, unless it is impracticable to do so because of terrain or unusual site characteristics. Such dwellings must provide for accessibility in all common and public areas. In addition, certain accessibility requirements must be included in all of the dwelling units in buildings with elevators, and in all of the ground floor dwelling units in buildings without elevators. They are:

- (a) Public and common use areas must be readily accessible to, and usable by, persons with disabilities;
- (b) All doors designed to allow passage into and within all premises are wide enough to allow passage by persons in wheelchairs; and
- (c) All premises contain the following:
 1. An accessible route into and through the dwelling unit;
 2. Light switches, electrical outlets, thermostats, and other environmental controls in accessible locations;
 3. Reinforcements in bathroom walls to allow later installation of grab bars; and
 4. Usable kitchens and bathrooms such that an individual in a wheelchair can maneuver about the space.

The above accessibility guidance is from the MAP guide dated March 15, 2002 - Section A - Page 1 of 8, Appendix 5 - Architectural Analysis.

I. Cost Benefit Analysis

The statute also requires a cost benefit analysis to justify the costs of refinancing. The costs of refinancing and rehabilitation have an absolute upper limit capped at the cost to develop a new unit of elderly housing. That limit therefore leads us to the establishment of a “basic benefit for the extension of the Section 202 use” of the project. For our purposes under this program, we are assuming that all other things (i.e., land and soft costs) being equal, the cost comparison to establish benefit is between the per-unit cost of rehabilitation, and per-unit cost to build new.

In developing the guidance for the cost benefit analysis, we first researched the available literature, including various reports to Congress, reports by the GAO, the Congressional Research Service and HUD’s Office of Program Development and Research to determine if there was an authoritative source for the value of the provision of a unit of elderly housing. While there are a number of estimates of cost, there are no authoritative sources for the value of a unit of elderly housing. Most of the research covers the costs of low-income

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subsidized elderly housing. Given that there is not an authoritative source for the value (i.e., the benefit of extending the useful life of the SH project), we determined that the inherent benefit is the deferral of the need and cost of developing a new unit of elderly housing.

J. Benefits

On the basis of the deferral of costs, we are establishing a basic benefit based upon the replacement cost new for a unit of elderly housing.

This basic benefit is based upon the deferral of such development costs for the statutorily required 20-year extension of the use of the unit of Section 202 elderly housing. Since such replacement costs vary by location, the base statutory limits have been adjusted by the HUD High Cost Factors. The basic benefit for a geographic area is calculated as 2/4ths (20 years/40-year rehabilitated building life) of the product of the per unit statutory limit times the local high cost percentage. Should an owner agree to extend the “Section 202” use of the property for a period greater than 20 years, the numerator would be the number of years of extended use. For instance, if the owner agreed to extend the “Section 202” use for 30 years, the extended basic benefit would be calculated as 3/4ths of the product of the per unit statutory limit times the local high cost percentage. The basic benefit can be adjusted as far as 4/4ths if the owner agrees to extend the Section 202 use for 40 years. (Attachment 2 details the considerations and calculations that went into the development of the “basic benefit.”). Note: For purposes of this Notice, basic “benefit” includes construction costs only and excludes land.

Besides the “basic benefit”, the proposal may have other benefits. While these other benefits may be more subjective and difficult to quantify, we expect that other benefits can be calculated and valued based upon the specifics of the owner’s proposed rehabilitation, retrofit, or renovation.

Potential benefits to the project and the residents from the prepayment, refinancing, repair, rehabilitation, and retrofit may include benefits from:

- “ENERGY STAR” appliances and components – A reduction in utility costs and particularly in tenant paid utilities.
- The provision of low-income housing - Owners may choose to set aside additional units for low-income tax credit eligible units which might possess the possibility of increasing any associated benefits.
- The provision of services that extend the period of independent living and avoid early institutionalization.
- Improved handicapped accessibility to extend the period of independent living.

- Improvements in the tenants' quality of life from retrofit and renovation and/or the provision of amenities.

As with the calculation of the basic benefit, for the purposes of this analysis, we assume that the lifetime of the depreciable basis of rehabilitation is also 40-years. So the benefits value that accrues to the property is calculated as the number of years of extended use/40 year rehabilitation component life as done with the calculation of the basic benefit.

Lastly, the benefits that accrue from the provision of services may be estimated based upon their projected annual costs for the number of years agreed to by the owner in its extended use agreement. For such costs to be included in the calculation of benefits, the owner's proposal must show that it has sufficient funds or a firm commitment for such funds.

K. Costs

The cost side of the cost benefit analysis will be driven by the market costs of the loan, the transaction, repair, retrofit, and rehabilitation costs. The calculation of these costs should be relatively straight forward. One cost issue stands out however. The statute requires:

The prepayment plan for the transaction, including the refinancing, shall meet a cost benefit analysis, as established by the Secretary that the benefit of the transaction outweighs the cost of the transaction **including any increases in rent charged to unassisted tenants.**

The calculation of costs must therefore include "any increases in rent charged to unassisted tenants."

The owner's cost benefit analysis must include:

- A detailed listing of the sources and uses of funds.
- A list of current tenants by unit and showing current rents and proposed rents, and subsidy eligibility.
- A narrative discussion of the benefits from the transaction including the benefits to the tenants.
- A summary table showing the details of cost and the estimates of and calculations of benefit.

Add the total of the annual rent increases for any **un-assisted** tenants ineligible for subsidy times number of years of Section 202 use extension to the total cost of the transaction to get a total cost to compare against the calculated benefit.

L. Rents and Subsidy Rents

- For those units receiving rent subsidies under Section 8, the statute states: The overall cost for providing rental assistance under Section 8 for the project (if any) is not increased, except, upon approval by the Secretary to:
 - a. Mark-up-to-market contracts pursuant to Section 524(a)(3) of the Multifamily Assisted Housing Reform and Affordability Act (42 U.S.C. 1437f note), as such section is carried out by the Secretary for properties owned by nonprofit organizations; or
 - b. Mark-up-to-budget contracts pursuant to Section 524(a)(4) of the Multifamily Assisted Housing Reform and Affordability Act (42 U.S.C. 1437f note), as such section is carried out by the Secretary for properties owned by eligible owners (as such term is defined in Section 202(k) of the Housing Act of 1959 (12 U.S.C. 1701q(k));
- The project owner may charge tenants rent sufficient to meet debt service payments and operating cost requirements, as approved by the Secretary, if project-based rental assistance is not available or is insufficient for the debt service and operating cost of the project after refinancing. Such approval by the Secretary shall be the basis for the owner to agree to terminate the project-based rental assistance contract that is insufficient for the debt service and operating cost of the project after refinancing; and
 - a. Shall be an eligibility event for the project for purposes of Section 8(t) of the United States Housing Act of 1937 (42 U.S.C. 1437f(t)); and
 - b. Units to be occupied by tenants assisted under Section 8(t) of the United States Housing Act of 1937 (42 U.S.C. 1437f(t)) shall, upon termination of the occupancy of such tenants, become eligible for project-based assistance under Section 8(o)(13) of the United States Housing Act of 1937 (42 U.S.C. 1437f(o)(13)) without regard to the percentage limitations provided in such section.

M. Acceptable Project Ownership

1. The project must be owned and maintained by the current ownership entity, or;

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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; or
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.

N. Use of Certain Project Funds

The Secretary shall allow a project owner that is prepaying and refinancing a project under this Notice to use any Residual Receipts held for the project in excess of \$500 per individual unit or, use any Reserve for Replacement in excess of \$1,000 per individual unit for activities to rehabilitate, modernize, or retrofit the buildings, common areas, or individual dwelling units. Note: Residual Receipts Accounts usage must be consistent with outstanding instructions as directed by the Department.

O. Tenant Notification

1. At least 30-days before submitting a request for prepayment to HUD, the Owner must notify the tenants of its intention to prepay. The Notice must address how the prepayment is advantageous to the tenants.
2. The Notice must be delivered directly to each unit in the project or mailed to each tenant and posted throughout the project including the project office, and in at least (3) three common areas.

Note: In a project greater than (4) four 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.

3. For a period of thirty days from the date on which the Notice is served to the tenants, 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.

4. The tenants have the right, during this period, to submit written comments on the proposed prepayment to both the Owner and the local HUD Office. Tenant representatives may assist tenants in preparing these comments.
5. Any tenant comments must be available in the project office during normal business hours for public reading and copying. 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 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 provided the materials necessary for the tenants to formulate a response to the owner's request to prepay.

P. A Use Agreement is required for HUD Approval of the Prepayment Request

1. <http://www.hud.gov/offices/adm/hudclips/notices/hsg/files/02-16a4.doc> is the outline Use Agreement that will be used for prepayments under this Notice. The statutory requirement for the Use Agreement is that it extends the use of the property as a Section 202 project for an additional 20 years beyond the maturity date of the Section 202 loan.
2. The Use Agreement proposed for control of the use of the project upon the prepayment of the Section 202 loan must be submitted with the application for prepayment.
3. Because of the requirement for a cost benefit analysis to show the benefits from prepayment and refinancing, the Use Agreement must also include those conditions that the owner voluntarily proposes to provide additional benefits from the transaction.

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4. 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.
 - a. 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.
 - b. 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.
 - c. It should be noted that in a low-income tax credit proposal/transaction, the low-income tax credit Use Agreement should be held in first position.
 - d. If there is a conflict in deciding whether the Flexible Subsidy or Refinancing Use Agreement should be held in first position, please contact your Desk Officer in the Office of Asset Management for assistance.
 - e. As required by 24 CFR Part V Subpart H, within ninety days following the end of each fiscal year, the owner must submit a complete audited annual financial report based upon an examination of the books and records of the project in accordance with the requirements of HUD, certified to be an officer or responsible owner and, by a Certified Public Account, or other person acceptable to the Commissioner. This submission must be transmitted via the Department's FASS.

Q. Prepayment of Existing Flexible Subsidy Loans

If a Section 202 project has a Flexible Subsidy loan or a HELP loan, these loans must be repaid at the same time the Section 202 Direct Loan is prepaid. Any Use Agreement imposed from the use of Flexible Subsidy funds shall remain in effect. For the details, see the existing policy and procedures for the deferred repayment of Flexible Subsidy Loans. Note: Flexible Subsidy loan repayment must be consistent with outstanding instructions as directed by the Department.

R. Termination of Rent Supplement Contract

A Rent Supplement Contract normally terminates upon prepayment of the Section 202 Direct Loan. Therefore, if a Section 202 project has a Rent Supplement Contract, HUD staff should request a listing of tenants receiving Rent Supplement Assistance and request vouchers for those tenants prior to the prepayment. See the existing guidance in PIH Notice 01-41 for the details regarding the request and issuance of vouchers.

S. Prepayment Consultation with Hub or Program Center Staff

An Owner considering prepayment should consult with its Housing Project Manager in the appropriate Hub/PC before proceeding. This meeting should cover the following at a minimum:

1. The conditions required for prepayment.
2. Tenant notification requirements.
3. The requirement for a Cost Benefit Analysis including, “benefits to the tenants.”
4. The terms and conditions of the Use Agreement and the owner’s options to increase the benefits to the tenants.
5. Section 8 Contract issues resulting from prepayment.
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 a 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.

T. Application to Prepay the Direct Loan

The Owner must submit:

1. A written request to the appropriate Hub/PC
<http://www.hud.gov/offices/adm/hudclips/forms/files/9808.doc>;
2. A copy of:
 - a. The mortgage and mortgage note;

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- b. Housing Assistance Payment Contract;
 - c. Regulatory Agreement;
 - d. All tenant comments and the Owner's written evaluation of the comments; and
 - e. Any other use agreements/restrictions, subordinate mortgages/loans that may be in place.
- 3. Details of the repairs/rehabilitation/retrofit.
 - 4. List of households currently residing in Section 8 or Rent Supplement assisted units.
 - 5. List of any commercial renters/leases or vendors that may be in place.
 - 6. If applicable, statement regarding application for FHA mortgage insurance or Risk Sharing Program.
 - 7. Additional documents, where/if deemed necessary, if HUD must approve the prepayment.
 - 8. A detailed narrative explaining the benefits of the proposal to the tenants.
 - 9. Draft copy of the Use Agreement which will be recorded at the time of prepayment.

U. Hub and Program Center Responsibilities

- 1. Subsidy Layering Review Requirements
 - a. In all prepayment cases where the Section 202 project receives HUD Housing assistance, such as project-based Section 8, and receives or is expected to receive other governmental assistance, such as HOME, CDBG, a Subsidy Layering Review, including either a Section 102(d) certification by HUD staff or a Section 911 certification by a Housing Credit Agency is required.
 - b. Where the other housing assistance includes Low Income Housing Tax Credits, the

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tax credit allocating agency performs the subsidy layering review.

- c. If the prepayment proposal does not contemplate financing through FHA mortgage insurance or HFA or GSE risk-sharing, the subsidy layering review must be completed by the appropriate reviewing body prior to approval of the prepayment.
- d. If the prepayment proposal contemplates FHA mortgage insurance or risk-sharing, the subsidy layering review must be performed in conjunction with the processing/approval of the FHA mortgage insurance application or risk-sharing package.

2. Prepayment Request Processing

Multifamily Hubs and Program Centers must process a Section 202 prepayment request within 30 days of receipt (or within appropriate timeframes if the transaction involves FHA mortgage insurance). Hub Directors may approve acceptable prepayment proposals if Headquarters has issued a written “Prepayment Checklist Approval,” approving the prepayment of Section 202 Direct Loan. The Hub/PC must evaluate the proposal.

- a. Review the Prepayment submission as outlined in <http://www.hud.gov/offices/adm/hudclips/notices/hsg/files/02-16h.doc> as a guide.
- b. Verify that all tenant notification procedures have been followed.
- c. Review any comments received from the tenants and determine if the owner has made acceptable response.
- d. Determine that adequate justification and documentation is provided to demonstrate the cost benefit of the transaction.
- e. 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.
- f. Prepare an analysis of the prepayment proposal and approve acceptable proposals providing a brief description of the basis for the approval or rejection of the Owner’s prepayment proposal.

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- g. Field Office will complete the “Field Office Checklist for Prepayment” form and submit it to the appropriate Desk Officer in the Headquarters Office of Asset Management for review and approval.
- h. 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.”

V. Final Processing

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.

Notify the Owner of:

- 1. Hub Director’s approval of the prepayment request, using <http://www.hud.gov/offices/adm/hudclips/notices/hsg/files/02-16h.doc> as a guide. The approval letter shall reference the final prepayment proposal that was agreed to by HUD and the project sponsor/owner.
- 2. The payoff date and amount for the Section 202 Direct Loan and, if applicable, the Flexible Subsidy or HELP Loan(s).
- 3. Request evidence for the recordation of the Use Agreement.

W. FHA Mortgage Insurance & Risk-Sharing Processing

- 1. 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.
- 2. The project sponsor and a HUD approved multifamily lender or Housing Finance Agency (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, the sponsor of the prepayment request

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should 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.

X. A Transaction with Project-Based Section 8 or Other Project-Based Rental Subsidies:

1. The rents used in FHA mortgage insurance processing will be the lesser of:
 - a. Comparable unassisted market rents; or
 - b. 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 Traditional Application Processing (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 N 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 Account for the FHA insured mortgages must still be established in accordance with outstanding underwriting instructions. Risk-sharing

