

Chapter 9

Servicing and Monitoring

Executive Summary

Section 9-1

This chapter describes the Mark-to-Market Notes generated from the restructuring process, and the overall servicing responsibilities, including cash and asset management, of the first mortgage, Mortgage Restructuring Mortgage, Contingent Repayment Mortgage, and Rehabilitation Escrow.

First Mortgage Servicing

Section 9-2

First Mortgage Servicing. The first mortgage lender maintains cash management responsibility in accordance with the terms of the Note, Mortgage, Regulatory Agreement and the Mark-to-Market Rider to the Regulatory Agreement. The lender is responsible for administration and maintenance of the impound accounts (Reserve for Replacement, Property Tax, etc.). If the restructured deal includes repairs funded at closing through a rehabilitation escrow account, the first mortgage lender (or another rehabilitation escrow administrator) will maintain the rehabilitation escrow account. The asset management of the first mortgage, if there is an FHA-insured or HUD-held mortgage after restructuring, is the responsibility of the local Multifamily Hub or Program Center.

In the event there is a complete write-down and no take-out financing, the Mortgage Restructuring Mortgage (or if no Mortgage Restructuring Mortgage, the Contingent Repayment Mortgage) will be the first mortgage. In this event, the HUD Multifamily Financial Operations Division/Multifamily Notes Branch or its designee will service the note.

Mortgage Restructuring Mortgage Servicing

Section 9-3

Mortgage Restructuring Mortgage Servicing. In general, the Mortgage Restructuring Mortgage (MRM) is in second mortgage position. The Mark-to-

Market Notes and Mortgages secure the repayment of HUD's mortgage insurance claim payment. In order to monitor and optimize the value of HUD's interest, Asset and Cash Management services will be provided by HUD or a Contractor. Enforcement of any rights under the Mortgage Restructuring Mortgage is subject to approval of the MF Hub or Program Center Director.

- A. Cash Management: The HUD Multifamily Financial Operations Division/Multifamily Notes Branch or its designee will provide the cash management servicing of the Mortgage Restructuring Note. Responsibilities include lock box payment receipt control, accounting records, billing, and reporting.
- B. Asset Management: The terms of the Mortgage Restructuring Note call for an annual payment based on a stated percentage (usually 75%) of surplus cash from the property. The surplus cash amount is initially captured from the project's fiscal year-end Annual Financial Statement (AFS) submitted by the owner to the HUD Real Estate Assessment Center (REAC).
- C. Post-Closing: A Post-Closing Portfolio Management Contractor will be responsible for the following:
 - 1. review and analysis of the AFS and other REAC and Asset Management data for approval criteria for any Capital Recovery Payment and Incentive Performance Fee,
 - 2. review and analysis of AFS for correct calculation of surplus cash and subsequent calculation of mortgage loan payment due to HUD; notifies Cash Manager of amount due,
 - 3. make payment demand in the event the owner fails to make annual payment,
 - 4. review the project financial statements, perform variance analysis of the actual operating expenses against those used in underwriting, develop recommendations for budgets, note payments, capital and maintenance expenditures, and other asset management options,
 - 5. site visits, physical inspections, meeting with tenants, and other actions as requested,
 - 6. maintain appropriate records, and
 - 7. work with the local FHA Asset Manager and Office of Housing personnel to optimize the value of HUD's interest in the M2M Notes.

Contingent Repayment Mortgage Servicing

Section 9-4

Contingent Repayment Mortgage Servicing. The Contingent Repayment Mortgage (CRM) is generally in third position, behind the first mortgage and the MRM. In the absence of a MRM, the CRM falls in second mortgage position. In the event there is a complete write-down and no take-out financing, and there is no MRM in place, the CRM can be in first mortgage position. Servicing of the Contingent Repayment Mortgage is limited (so long as the Mortgage Restructuring Mortgage is outstanding) to accounting for principal and interest balances, accepting payments, and other administrative functions. If the Mortgage Restructuring Note is paid in full prior to its maturity or was never created, the Contingent Repayment Note will generally assume the position and payment terms of the Mortgage Restructuring Note, including oversight and servicing outlined in Section 9-3. The CRN is due in full at maturity.

Administering the Rehabilitation Escrow

Section 9-5

- A. **Applicability.** This Section applies to M2M debt restructure transactions that use the M2M standard form legal document “Rehabilitation Escrow Deposit Agreement.” (REDA)
- B. **Compliance and Monitoring Activities.** The Rehabilitation Escrow Administrator (REA) will oversee administration of the rehabilitation escrow as provided in the REDA, and:
 1. Manage the escrow account, including set-up of the account in a manner that ensures the funds would be available to the Secretary in the event of a bankruptcy filing on behalf of the property, fund investment (ensuring the funds are collateralized/protected in the event the financial institution fails). Each project’s escrow funds must be maintained in a separate interest-bearing account not commingled with any other funds.
 2. Engage, at the REA’s expense, a qualified third party inspector to verify that work is completed in accordance with the scope of work identified in the REDA. The REDA typically requires that all work be inspected prior to payment. The REA may need to arrange for multiple inspections if multiple invoices are received throughout the rehab period.
 3. Review and approve requests for payment.
 4. Provide OAHF with periodic reporting on the status of the work and or account, up until account closure.

5. Coordinate, review and submit any requests for extension, scope of work modifications, etc. or final certification of completion to OAHP, using Form 9.10.
6. Upon completion of work:
 - a) Excess Funds. Distribute any excess escrow funds in accordance with the REDA, which provides generally that excess funds are applied as directed by HUD. Typically, HUD will direct that funds be applied to the Mortgage Restructuring Note while HUD is the holder of the MRN (or in the event there is no Mortgage Restructuring Note, the Contingent Repayment Note). Any use of excess escrow fund other than as payment toward MRN/CRN must be approved in advance by OAHP.
 - b) Deficit Funds. The owner is responsible for funding any deficits from non-project sources.
7. If the owner fails to comply with the Rehabilitation Escrow Deposit Agreement (an “Event of Default”), the REA has the following duties:
 - a) To notify OAHP.
 - b) To notify the owner.
 - c) To coordinate with OAHP one or more of the following actions to be taken by HUD (as directed by OAHP):
 - i. Issuance of a notification from HUD to the owner in writing that, without limiting HUD’s other remedies, the owner’s failure constitutes a HUD management finding that, until cleared, prevents the owner from paying further Capital Recovery Payments and prevents the owner from earning (or receiving) Incentive Performance Fees.
 - ii. Inform the responsible HUD Project Manager that the Real Estate Assessment Center’s inspections should be resumed.
 - iii. Make an entry in the Multifamily APPS system (place a “red flag”) regarding the non-performance of the owner.
 - iv. Make a voluntary referral to HUD’s Departmental Enforcement Center using the procedures currently in use by HUD’s Office of Multifamily.
 - v. Adjust contract rent levels, in situations where the rehabilitation included work that led to an adjustment in

the rent levels (such as air conditioning), and where that work was not completed.

Mark-to-Market Use Agreement Compliance Monitoring

Section 9-6

The M2M Use Agreement will be monitored by HUD or designated contractor serving as a Contract administrator. In the presence of an FHA insured first mortgage, M2M MRN or CRN mortgage, or project-based Section 8 contract, most of the requirements of the M2M Use Agreement will be monitored through the regulatory provisions in those documents. Per the terms of the M2M Use Agreement, tenants and other third parties also have certain enforcement rights.

Section 8 Contract Administration

Section 9-7

Public PAEs have the option to serve as Contract Administrators for any of the properties for which they provided the (Lite or Full) Restructuring Plan. Compensation and performance standards will be established in an Annual Contributions Contract (ACC) and will be consistent with those used in Housing's solicitation for Contract Administrators for the non-M2M portfolio.

HUD may engage Performance Based Contract Administrators (PBCAs) to administer the post-M2M Housing Assistance Payment (HAP) contracts.