
CHAPTER 11. SALE OF LIMITED DISTRIBUTION MORTGAGE TO
NONPROFIT OR COOPERATIVE MORTGAGOR

- 11-1. GENERAL. The statute and the Project Mortgage Regulations permit a limited dividend sponsor/owner to prepay a Section 236 mortgage without prior consent of the Commissioner, provided the project is sold to a nonprofit or cooperative entity, and further provided that the purchaser and the terms of the sale are approved by HUD-FHA.
- a. The Sale of a Finally Endorsed Section 236 Mortgage may be consummated through either of two methods.
- (1) A nonprofit or cooperative organization may assume the liability of an existing mortgage and pay for the LD mortgagor's equity out of its own resources. In this case, the outstanding interest reduction contract would not be disturbed.
 - (2) In the more usual case, the outstanding indebtedness would be refinanced with a new mortgage. The amount of such a new mortgage must not exceed the lesser of:
 - (a) An amount, the debt service of which can be met from project income remaining after payment of all operating expenses, taxes, and required services, provided the project is operated on a nonprofit basis and the rental charges in effect at the time of the purchase are not raised, or
 - (b) Whichever is greater of the project's actual cost at the time of completion (as determined by HUD) or the project's fair market value for residential purposes as determined (by HUD) on the basis of operating the project without the benefit of any interest reduction payments or rent supplement payments and without the controls by the Assistant Secretary-FHA Commissioner over the project imposed by the provisions of FHA Regulations for Project Mortgage Insurance, Chapter II, Subchapter A, Part 236, Subpart A.
- b. The Term of the Refinanced Mortgage may exceed the remaining term of the original mortgage on the project but in no event may it exceed the remaining economic life of the project (as determined by HUD).

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- c. Section 236 Funding Authority contracted for under the term of the original mortgage may be cancelled and reused for the new mortgage. However, some increase in contract authority may be required from funds available in the field office to cover the increased mortgage under a nonprofit form of ownership.
- 11-2. CONDITIONS. The sale and conveyance of a property covered by an insured mortgage necessitates a substitution of mortgagors. HUD-FHA approval of the substitution is required in every case in which HUD-FHA exercises control over the mortgagor (as by a Regulatory Agreement). It is essential that a thorough analysis be made of all facets of proposed transfer transactions, including the status of the insured mortgage, the financial and physical condition of the project, and the acceptability of the proposed purchaser.
- a. The Policies and Procedures established in Reference (13) of the Foreword with respect to substitution of mortgagor will apply to sales of Section 236 projects, except as amended herein.
- b. Reprocessing. When a new mortgage would be involved, the case must be reprocessed to determine the new mortgage and subsidy amounts. Reprocessing must take into account the adequacy of current operating expense ratios and any prior or continuing tax abatement.
- c. Eligibility of Nonprofit Purchaser. A nonprofit corporation which proposes to purchase an insured Section 236 project is subject to an examination for eligibility as a nonprofit housing sponsor (FHA Form 3433) in the same manner as if it were sponsoring new construction.
- d. Eligibility of Cooperative Purchaser. A cooperative entity which proposes to purchase an existing Section 236 project is subject to a 90% presale requirement. Approval of the substitution of mortgagors is contingent upon fulfillment of this requirement and the requirement will not be waived or reduced. Waivers will not be permitted because the time period which can be anticipated between the approval of the substitution and actual consummation of the sale of a project ready for occupancy is much shorter than the period between HUD-FHA preliminary approval of proposed construction and final endorsement.
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- e. Correction of Deficiencies. In addition to the interim financial statement required of the seller, an audit of the project (by the Office of Audit) and a physical inspection of the project must be made prior to conveyance of the property. Any financial deficiencies, objectionable financial policies, management or operational discrepancies, or defects in the physical condition of the property must be corrected before the sale is consummated. Satisfactory evidence that the corrections have been made must be submitted to the field office and, if necessary, another audit and inspection will be made prior to approving the sale.
- 11-3. PROJECTS IN DEFAULT. In the case of Section 236 projects in default, whether or not a modification agreement is involved, preliminary approval of a sale will be withheld pending satisfactory arrangements for restoring the mortgage to a nondefault status. Full reinstatement will be required prior to or simultaneously with completion of the sales transaction.
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