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

OFFICE OF HOUSING

APR 19 2013

MEMORANDUM FOR: All Multifamily Hub Directors
All Multifamily Program Center Directors
All Multifamily Operations Officers
Office of General Counsel

FROM: Marie D. Head, Deputy Assistant Secretary for Multifamily Housing Programs, HT

SUBJECT: Guidance for Processing Interest Rate Reduction Requests

The purpose of this memorandum is to provide guidance for processing requests by mortgagees to reduce the interest rate on an insured mortgage loan and to clarify the Office of Multifamily Housing's procedures for processing requests to reduce the interest rate and re-amortize the loan. The Office of Asset Management will oversee this process.

This memorandum does not apply to an Interest Rate Reduction request that requires HUD to waive prepayment penalties or override lockout provisions to avoid a mortgage insurance claim. Refer to Chapter 14 of HUD Handbook 4350.1, *Multifamily Asset Management and Project Servicing*, and Mortgagee Letter 87-9, *Mortgage Prepayment Provisions for HUD-insured and Coinsured Multifamily Projects*, which have detailed requirements for processing such a waiver request.

BACKGROUND:

Due to historically low interest rates, and as an alternative to a refinance under Section 223(f) or Section 223(a)(7), a mortgagor may request a reduction of the interest rate on their existing multifamily mortgage loan; thereby significantly improving the property's cash flow. Historically, the Department has not considered reductions in interest rates for multifamily insured loans unless it was requested to avoid a mortgage insurance claim. However, due to historically low interest rates, the Department has seen a significant increase in the number of mortgagors, whose mortgage loans are not in default, request a reduction in the mortgage loan's existing interest rate. Currently, all requests for an interest rate reduction are approved by the Director, Office of Asset Management in Headquarters.

PROCESSING GUIDANCE:

Mortgagees and mortgagors may negotiate whether it is in the best interest of the project to request a reduction in the interest rate. A reduction in the interest rate will adjust the amount of the payments in the amortization schedule only. The maturity date and other mortgage loan terms should not be affected.

Transactions subject to lockout provisions may not request a reduction in the interest rate prior to expiration of the lockout period. Many properties have prepayment penalties after the lockout period. With current historically low interest rates, many borrowers and lenders may agree to a reduction in the interest rate, even with significantly high prepayment penalties.

Previously refinanced Section 202 projects that participate in the Interest Rate Reduction program will remain exempt from the Multifamily Assisted Housing Reform and Affordability Act (MAHRA) of 1997. If, however, the previously refinanced Section 202 project refinances their existing loan with an FHA insured mortgage, the exemption will be lost. The debt service savings that result from an Interest Rate Reduction transaction will remain in the project's operating account.

Consistent with FHA's long-standing practice, lenders/servicers are permitted to pay for all or a portion of the borrower's prepayment penalties through funds generated from trade profit (also known as "premiums" or "marketing gain"). Such approval is subject to the following conditions:

- No other borrower costs may be paid by the lender or its affiliates without prior written permission from HUD. Without approval, such payments are considered a prohibited "inducement" and may result in referral for enforcement action. Nominal excess amounts of trade profit may, with disclosure and permission, be deposited into the project's Reserve for Replacement account.

- Excess trade profit may be retained by the lenders (subject to the disclosure requirements of Mortgagee Letter 2011-5, *Revised Audited Financial Statement Reporting Requirements for Supervised Lenders in Parent-Subsidiary Structures and New Financial Reporting Requirements for* Multifamily *Mortgagees*, and the associated questions and answers, posted at http://portal.hud.gov/hudportal/documents/huddoc?id=qna_mtgeeltr11-05.pdf). This Mortgagee Letter requires disclosure of trade profits greater than 5 percent, including any such funds used to pay prepayment penalties.

- If the trade profit is being used to pay project expenses, fund the Reserve for Replacement account or the mortgagee is waiving normal expenditures, full disclosure of all anticipated project trade profit must be disclosed to the borrower and HUD. A sources and uses statement included as part of a Financing Plan must detail the anticipated amount of trade profit and amounts used for the prepayment penalty and/or other project expenses associated with the mortgage note.

PROCEDURES:

Mortgagee Responsibilities:

Mortgagees should submit a package to their local Hub/PC Director requesting an interest rate reduction. The package submitted to the local HUD Office for review should be sent in accordance to the instructions listed below.

Current Loans:

Current loans are defined as those loans that have not been in financial or technical default within the past 24 months. The submission package for current loans must include:

- A summary of the transaction detailing the projected change in interest rate.
- A certification from the lender that they will follow Ginnie Mae's guidance for the liquidation of the security to include any prepayment penalty due.
- Debt Service Coverage (DSC) analysis at the estimated interest rate for the revised loan.
- A Sources and Uses statement prepared for the borrower. Third party lender costs such as attorney fees, Ginnie Mae Fees, title and recording costs must be disclosed whether paid by the lender or owner.
- If Trade Profit is being used for something other than mortgagee costs or the mortgagee is waiving normal costs (interest), a full disclosure of the amount of Trade Profit must be made to the borrower and HUD.
- Most recent interim and year-end financial statements.
- Draft closing documents for the interest rate reduction request to be reviewed by local HUD Office of General Counsel.[1]
- A prepaid envelope for returning executed documents to the mortgagee for filing.

Defaulted Loans:

Defaulted loans are defined as those loans that are, or have been in financial or technical default within the last 24 months. For these loans, the following must be included in the package to the local Hub/PC:

- A Preservation Capital Needs Assessment (PCNA) and discussion of Reserve for Replacement account adequacy is required. The Multifamily Hub Director is delegated the authority to waive the PCNA requirement if the project was recently constructed or substantially rehabilitated, or a PCNA was conducted within the past 5 years, and the

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[1] Servicers will be notified when a package has been approved or has been forwarded to HQ. If the loan has not yet been locked, Servicers may deliver final executed documents representing the locked rate and with attorney certification of no changes to the approving official. If the difference between the expected rate and the final rate affects the DSCR negatively by more than .10 or takes it below 1.05, then communications between the servicer, Hub Director and HQ, if necessary, must occur to ensure approval is still appropriate. Mortgagees should receive Hub Executed documents within 5 business days after receipt of final documents.

project is in good physical condition as documented by Real Estate Assessment Center (REAC) scores and/or HUD's staff personal knowledge of the property.

- An explanation of specific problems, events, and trends that caused or were contributing factors to the default and how this transaction will resolve them.

An explanation of where funds will be obtained to bring the loan current, fund the Reserve for Replacement account and resolve any outstanding payables.

Field Office Responsibilities:

Utilizing the attached checklist, the Hub/PC shall review the package submitted by the mortgagee to ensure compliance with policy. In addition, the Hub/PC shall complete the following:

- Verify the Owner is in compliance with all business agreements. If the project is not in compliance with its business agreements, the mortgagor/mortgagee must show how this transaction will bring the project into compliance.

- Review Management and Occupancy Reviews (MORs) and REAC physical inspection reports and confirm that all open issues have been satisfactorily addressed.

- Review financial statements to ensure that the revised loan will have a DSC ratio greater than 1.05.

- Review the sources and uses to verify lender costs are disclosed and reasonable.

- Review Ginnie Mae's online database to verify the loan is not subject to a lockout. https://structuredginniemaes.ginnienet.com/multifam/. No recommendation for approval may be generated until **AFTER** the lockout has expired.

- Review Mortgage documents to effectuate the change in rate (the local Office of General Counsel must also review these documents and provide their written acceptance).

- Verify that there have been no unauthorized Owner distributions.

- If a PCNA is required, determine that the Replacement for Reserve account is adequately funded and that annual contributions are sufficient to address future needs.

- If applicable, prepare a memorandum to the Director, Office of Asset Management, recommending approval of the transaction, including any justification for the use of the trade profit for purposes other than prepayment penalties or third party lender costs.

Interest Rate Reduction Approval Process:

For current loans (defined above) and where there is **NO** request for use of the Trade Profit for anything other than mortgagee costs, Hub Directors are authorized to approve and execute documents to effectuate the interest rate reduction. Hub/PC staff should complete the checklist and prepare a memorandum recommending approval of the Interest Rate Reduction to the Hub Director. The Hub Director will prepare and send the approval letter to the lender. It is expected that once a full packet has been submitted to the Hub/PC for review by the Servicer, the final recommendation should be processed by the Hub Director within 20 business days of receipt.

After the transaction has closed, a copy of the approval memorandum and the executed checklist should be forwarded to the Deputy Director in the Office of Asset Management in Headquarters, until further notice.

For defaulted loans (defined above) or loans in which the Trade Premium will be used for other than prepayment penalties or lender costs, a memorandum should be forwarded to the Director, Office of Asset Management in Headquarters, recommending approval of the Interest Rate Reduction, along with the completed and executed checklist, documents required for execution of the Interest Rate Reduction that include HUD Notary blocks reflecting District of Columbia requirements, and a prepaid envelope addressed for return to the mortgagee.

The mortgagee must send a copy of the recorded documents to the Hub/PC Director for their files. The Hub/PC Director is responsible for forwarding a copy of the recorded documents and mortgage note with the new payment terms to the Director, Office of Multifamily Insurance Operations in Headquarters, and for ensuring that a copy of the documents are included in the Washington Docket.

GINNIE MAE PROCESSING GUIDANCE

The borrower and mortgagee must comply with all Ginnie Mae processing requirements for the Interest Rate Reduction. If there are questions about these processes, they should contact their Ginnie Mae representative. Any issues involving the Ginnie Mae security must be resolved prior to approval of the Interest Rate Reduction request by the Department.

The guidance outlined in this memorandum is effective as of the date of this memorandum and applies to all Interest Rate Reductions that have not yet been submitted to Headquarters for approval. Please contact Norman Dailey at (202) 402-8371 if you have questions and/or concerns.

Attachment:

Interest Rate Reduction Request Checklist

Cross References:

Chapter 14, HUD Handbook 4350.1
Mortgagee Letter 87-9
Mortgagee Letter 2011-5

INTEREST RATE REDUCTION CHECKLIST

Submission from Servicer:

Date Submission received from Servicer: _____

Y/N

_____ Summary of the transaction that includes:
- If the Trade Profit will be used for other than mortgagee costs.
- If project is in non-compliance with HUD business agreements, how the transaction will bring the project into compliance.
- If in default:
  - A discussion on specific problems, events and trends that caused the default.
  - An explanation of where funds will be obtained to bring the loan current

_____ Certification that the Servicer will follow Ginnie Mae guidance for liquidation of the security to include any prepayment penalty due.

_____ Debt Service Coverage (DSC) analysis at the estimated interest rate for the revised loan

_____ Most recent Interim and Year-end Financial statement

_____ Draft Closing Documents

_____ PCNA (only required if the loan has been in default during the last 24 months.

_____ Prepaid envelope for returning executed documents.

Field Analysis

Y/N

_____ Verification owner is in compliance (or will be) with all business agreements.

_____ Review completed of MOR and REAC reports for any outstanding issues.

_____ Review Draft Sources and Uses

_____Verification of no unauthorized distributions.

_____ If required, PCNA reflects Reserve for Replacement account is adequately funded and that annual contributions are sufficient for future needs.

_____ E-mail or memorandum from local OGC counsel on acceptability of mortgage documents.

Date Lockout Expired from Ginnie Mae database: _____.

Projected DSCR: _____**(Must exceed 1.05)**

Date memorandum to Hub Director recommending approval: _____

Prepared By:_____ Date:_____

Reviewed By:_____ Date:_____

PC Director:_____ Date:_____

Hub Director:_____ Date:_____*

*The Hub Director's signature is required for all request for Interest Rate Reductions sent to Headquarters for approval.