

Mortgage Prepayment/General Management Issues

Legal Opinion: GHM-0019

Index: 3.300

Subject: Mortgage Prepayment/General Management Issues

January 21, 1992

Mary Martell, Esq.  
Biasucci and Martell  
1718 Connecticut Ave., NW  
Washington, DC 20009

Re: Lakeside Apartments  
Baltimore, Maryland  
Project No. 052-44113

Dear Ms. Martell:

This is in response to your letter of January 3, 1992 requesting confirmation of your interpretation of the prepayment restrictions on the mortgages for the captioned project.

Lakeside Apartments (the "Project") secures a multifamily project mortgage insured under section 236 of the National Housing Act (the "Section 236 Mortgage"), as well as an Operating Loss Loan insured under section 236 pursuant to section 223(d) of the National Housing Act (the "Operating Loss Loan"). These loans were finally endorsed for insurance on April 30, 1974 and February 11, 1975, respectively. Neither deed of trust note contains the standard twenty-year prepayment prohibition for limited distribution mortgagors. You requested confirmation that, despite the lack of any language in the notes prohibiting prepayment of the loans in full during the first twenty years following final endorsement, the prepayment prohibition in 24 CFR 236.30(a)(1) is applicable to both loans and that the loans may be prepaid only in accordance with a plan of action approved by the Department pursuant to the Low Income Housing Preservation and Resident Homeownership Act of 1990 ("LIHPRHA").

Section 236.30(a)(1) permits an owner, without the Secretary's consent, to prepay its mortgage only:

"(i) If the prepayment occurs after the expiration of 20 years from the date of final insurance endorsement of the mortgage, provided the mortgagor is not receiving payments under a rent supplement contract pursuant to the provisions of part 215 of this chapter; or

(ii) If the prepayment occurs as a result of the sale of the project to a cooperative or private nonprofit association, provided the sale is financed with a mortgage insured under 236.40(d) of this part."

Pursuant to this provision, prepayment without the Secretary's consent cannot occur within the first twenty years after final endorsement unless the project meets the criteria of subparagraph (ii).

Section 236.30(f) provides that a mortgage which is eligible for prepayment under section 236.30(a)(1) may be prepaid in full only in accordance with a plan of action which has been approved by the Commissioner under LIHPRHA. Once the mortgage becomes eligible for prepayment under either subparagraph (i) or (ii) of section 236.30(a)(1), the Owner must comply with section 236.30(f) in order to prepay the mortgage.

In the immediate case, the Project is owned by a limited dividend partnership and there is no plan to sell the Project to a cooperative or nonprofit organization within the next three years. Therefore, the Owner is not eligible to prepay the Section 236 Mortgage without the Secretary's consent until twenty years after final endorsement of the mortgage. Although it is the Department's practice to place language to this effect in the mortgage note, the failure to explicitly state the prohibition in the note does not abrogate the regulatory prohibition on prepayment. If the Owner wishes to prepay the Section 236 Mortgage on or after the twentieth anniversary of final endorsement, the Owner may do so only in accordance with section 236.30(f), pursuant to an approved plan of action.

A distinction must be drawn between the Section 236 Mortgage and the Operating Loss Loan. Section 223(d) of the National Housing Act provides that when the Secretary determines that an operating loss loan is needed in order to supplement project income, the operating loss loan should be insured under the same section as the original project mortgage, under such terms and conditions as the Secretary may prescribe. Although we have not been able to find specific authority on this point, it appears that the mortgage note for the Operating Loss Loan should have included prepayment prohibition language consistent with section 236.30(a)(1). However, the origination of an operating loss loan is not accompanied by the execution of a regulatory agreement, and the prepayment of an operating loss loan, without prepayment of the first mortgage, would have no effect on continuation of low-income affordability restrictions on the project. In effect, the prepayment of an operating loss loan would be analogous to a partial prepayment of the first mortgage with a recasting of the remaining balance of the mortgage over the existing term. We have held that such partial prepayments that do not affect the term of the mortgage are not subject to the Eligible Low Income Housing Preservation Act of 1987. Likewise, we conclude that the prepayment of the Operating Loss Loan on or after the twentieth anniversary of final endorsement, without a prepayment of the Section 236 Mortgage, would not be subject to LIHPRHA.

If you have any further questions regarding this matter,

please contact Susan Sturman at 202-708-3667.

Very sincerely yours,

Harold A. Levy  
Chief Attorney  
Loan Management and Property  
Disposition Section