

Prepayment of Mortgage on Section 236-Insured Project

Legal Opinion: GHM-0036

Index: 3.346, 3.160

Subject: Prepayment of Mortgage on Section 236-Insured Project

June 2, 1992

Kip M. Sweda, Esq.
Roetzel and Andress
75 East Market Street
Akron, Ohio 44308-2098

Re: Kentway Apartments
Kent, Ohio
Project No. 042-44007

Dear Mr. Sweda:

This is in response to your letter of April 13, 1992 to Susan Sturman concerning the eligibility of the owner of Kentway Apartments to prepay its mortgage and terminate the low income use restrictions on the property.

Kentway Apartments (the "Project") is owned by Kentway, Inc. (the "Owner"), a private nonprofit organization. The Project is subject to a mortgage insured by the Secretary under Section 236 of the National Housing Act. The Owner requested permission from the HUD Cleveland Office to prepay the mortgage and received a reply from Garreth H. Dowlen, Director Housing Management Division, dated February 28, 1992. Mr. Dowlen indicated that, inasmuch as the Owner is a nonprofit organization, it is not entitled to prepay its mortgage. As counsel for the Owner, you then requested our opinion as to the right of the Owner to prepay the Section 236-insured mortgage.

Section 236.30 of Title 24 of the Code of Federal Regulations governs prepayments of mortgages insured under Section 236 of the National Housing Act. Paragraph (a)(1) of 24 CFR 236.30 provides that a limited distribution mortgagor may prepay a 236-insured mortgage without the consent of the Department where the prepayment occurs after twenty years from the date of final endorsement of the mortgage and no rent supplement contract exists or where the prepayment occurs as a result of the sale of the project to a cooperative or private nonprofit organization and the sale is financed with a mortgage insured under Section 236.40(d) of the regulations. In his February 28, 1992 letter, Mr. Dowlen's decision that the mortgage on the Project could not be prepaid after twenty years from final endorsement, was most likely based on the fact that the Owner is not a limited distribution mortgagor and is, therefore, not entitled to prepay its mortgage without HUD consent, as provided in Section 236.30(a)(1). However, this decision disregards the language of Section 236.30(a)(2).

Section 236.30(a)(2) of Title 24 of the CFR states that

"in all cases, except those outlined in Section 236.30(a)(1) , a mortgage indebtedness shall not be prepaid in full and the Commissioner's controls shall not be terminated unless the Commissioner gives his prior consent to such prepayment." The language contained in the Mortgage Note for the Project provides that " The debt evidenced by this Note may not be prepaid either in whole or in part prior to the final maturity date hereof without the prior written approval of the Federal Housing Commissioner." (The Note enumerates certain circumstances, including those contained in Section 236.30(a)(1), where prepayment is permitted without HUD consent, but those circumstances are not relevant to the issue at hand.)

Since the Project does not fall within the parameters of paragraph (a)(1) of Section 236.30 because the mortgagor is not a limited dividend entity, the Project must be subject to paragraph (a)(2), which controls in all other cases. Therefore, pursuant to Section 236(a)(2), the Owner may prepay its mortgage, but only after receiving the consent of the Department.

Prior to giving consent to the mortgage prepayment, the Department must comply with Section 250(a) of the National Housing Act. Section 250(a) states that where Departmental approval is required for a mortgage prepayment, such approval may not be given unless the Secretary makes the following findings:

"(1) the Secretary has determined that such project is no longer meeting a need for rental housing for lower income families in the area;

(2) the Secretary (A) has determined that the tenants have been notified of the owner's request for approval of a prepayment; (B) has provided the tenants with an opportunity to comment on the owner's request; and (C) has taken such comments into consideration; and

(3) the Secretary has ensured that there is a plan for providing relocation assistance for adequate, comparable housing for any lower income tenant who will be displaced as a result of the prepayment and withdrawal of the project from the program."

These findings should be made by the Housing Management Division in the Field Office and then forwarded to the Office of Preservation in Headquarters with the recommendation that the prepayment be either approved or disapproved.

The Department's current policy is that once the findings required by Section 250(a) are made, the Department is willing to consider the mortgage prepayment as long as the Owner agrees to comply with certain restrictions which are similar to those imposed on owners seeking to prepay their mortgages pursuant to the Low Income Housing Preservation and Resident Homeownership Act of 1990. The Owner must agree to:

1. maintain the housing as low and moderate income housing for the remaining useful life of the property, approximately fifty years from the date of the agreement;
2. rent to the same proportions of very low, low and moderate income families that resided in the project on January 1, 1987 or at the time of approval of the prepayment, whichever yields a greater number of very low income families;
3. limit rents for current tenants to the lesser of 30 percent of each tenant's adjusted income or the Section 8 existing fair market rent;
4. prevent the displacement of current tenants, except for good cause; and
5. make adequate expenditures to properly maintain the housing throughout the term of the agreement.

If the owner is amenable to these conditions, we suggest that you resubmit your request to prepay the mortgage to the Cleveland Field Office and ask that office to make the findings required under Section 250(a) of the National Housing Act. I have forwarded a copy of this letter to the Housing Management Division in the Cleveland Field Office in order to clarify our position as to mortgage prepayments requiring Departmental consent.

If you have any further questions regarding this matter, please contact Susan M. Sturman at 202-708-3667.

Very sincerely yours,

Gains E. Hopkins
Acting Chief Attorney
Loan Management and Property
Disposition Section