



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Special Attention of:

**All Regional Directors
All Multifamily Hub Directors
All Program Center Directors
All Owners and Management Agents of
Multifamily Insured Properties
All Contract Administrators**

Notice H06-11

Issued: August 8, 2006

Expires: August 31, 2007

Cross Reference: H2004-17

Subject: Prepayments Subject to Section 250(a) of the National Housing Act.

This Notice is intended to provide background and up-to-date guidance on HUD's policy and procedure regarding the prepayment of HUD-insured/held mortgages pursuant to the National Housing Act. This Notice does not apply to projects insured under Section 223(f) of the National Housing Act because that section of the Act contains its own provisions governing prepayment approval. This Notice supersedes all prior directives on the subject.

The Act

Section 250(a) of the National Housing Act states:

During any period in which an owner of a multifamily rental housing project is required to obtain the approval of the Secretary for prepayment of the mortgage, the Secretary shall not accept an offer to prepay the mortgage on such project or permit a termination of an insurance contract pursuant to Section 229 of this Act unless:

- 1. The Secretary has determined that such project is no longer meeting a need for rental housing for lower income families¹ 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*

¹ Section 250(c) defines the term "lower income families" by reference to section 3(b)(2) of the United States Housing Act of 1937 as "families whose incomes do not exceed 80 per centum of the median income for the area, as determined by the Secretary with adjustments for smaller and larger families, except that the Secretary may establish income ceilings higher or lower than 80 per centum of the median for the area on the basis of the Secretary's findings that such variations are necessary because of prevailing levels of construction costs or unusually high or low family incomes."

result of the prepayment and withdrawal of the project from the program.

Background

On April 27, 1982, Senator Dodd of Connecticut introduced S. 2444, to amend the National Housing Act by adding a new section related to the prepayment of subsidized FHA-insured mortgages covering "hundreds of thousands of units of housing built by private developers to provide homes for low-income tenants under the section 221(d)(3), section 236 and rent supplement programs." 128 Cong. Rec. 7853. Subsection (a) of S. 2444 is almost identical to the language in what subsequently became Section 250(a) of the National Housing Act. Senator Dodd observed that although many of the Section 221 and Section 236 projects had mortgages requiring the Secretary's consent to prepayment, "[a]ny of these owners, at any time, can prepay the mortgage and remove the project from the subsidized programs with permission from HUD. "Id. Senator Dodd stated that S. 2444 would provide "the needed standards that will insure that HUD does not allow owners to take these projects out of the subsidized market when doing so would be against the best interests of the tenants and low-income people generally." However, Senator Dodd also acknowledged that not all owners of Section 221(d)(3) and Section 236 projects were required to secure HUD approval to prepay their mortgages prior to withdrawing from the subsidy programs. Significantly, he pointed out to the Senate that "limited dividend-for profit-owners of section 221(d)(3) below market interest rate and section 236 projects who do not use rent supplements can prepay their mortgages and withdraw from the program at the end of twenty years, without securing any approval from HUD," and for these projects he proposed an owner incentives program that failed to be enacted.

Congress enacted Section 250 to ensure that HUD's subsidized insured multifamily housing portfolio would remain as a resource for lower income tenants and would not be diminished by owners seeking prepayment of the project's insured mortgage for the purpose of converting the project to either luxury apartments or condominium ownership. While the insured mortgage is in place, prior to a prepayment, the mechanism used by the Department to control a subsidized project's tenant eligibility and admission standards has been by means of a regulatory agreement executed by the project owner and the Commissioner and incorporated by reference into the project's insured mortgage. HUD ensured that Section 221(d)(3)/(5) Below Market Interest Rate (BMIR) project owners complied with the lower income tenant eligibility requirements of the program by inserting into the BMIR program Regulatory Agreement a requirement that "admission to the project shall be limited solely to families of low or moderate income, as defined by the Commissioner." Similar language was inserted into the regulatory agreements used by HUD for projects with mortgages insured under the Section 221(d)(3) Market Interest Rate program. In addition, the regulatory agreements for the Section 221(d)(3) program contained a clause stating that "[i]f there are rent supplement units in the project, the determination as to the eligibility of tenants for admission to such units and the conditions of continued occupancy shall be in accordance with the Rent Supplement Contract executed by the Owners and the Commissioner which is incorporated in and made a part of this Agreement." The regulatory agreements for the Section 236 program set out the mechanism for the determination of "basic rent" and "fair market rent" and also contain a requirement that the owner "shall limit admission to the project to those whose incomes do not exceed the limits prescribed by the Commissioner, with the exception of those tenants who agree to pay fair market rental." In addition, the regulatory agreements for the

Section 236 program contain a clause regulating tenant eligibility for units subject to a Rent Supplement Contract that is similar to the Rent Supplement clause set out in the regulatory agreements used in the Section 221(d)(3), and which language is quoted above.

The projects with mortgages insured and subsidized under the Section 221(d)(3)/(5) BMIR program, the Section 221(d)(3) with rent supplement program and the Section 236 program, and that constitute the universe of projects subject to Section 250 are now twenty to forty years old, and are in need of substantial amounts of rehabilitation to return them to a standard competitive with projects built more recently that serve the same tenant population. Consequently, in many cases when HUD receives a request from an owner of a subsidized project for permission to prepay the project's subsidized mortgage, the owner wants to retain the project as an affordable housing resource for the long term, but wants to prepay the existing subsidized insured mortgage as part of a refinancing and recapitalization of the project to effectuate much needed rehabilitation of the project through the sale of tax credits, and lower than market interest rate financing through the sale of tax exempt bonds, and grants.

Application of Section 250 to Prepayment Requests

Section 250(a) requires that its prepayment limitations are applicable to all prepayment requests where the Mortgage Note or Flexible Subsidy contract requires Secretary approval for prepayment. In all such cases, the Department must meet the three requirements of subsection (a) in order to permit prepayment.

Section 250(a)(1) finding may be satisfied in three different ways

1. **Scenario #1.** If the project does not receive a subsidy pursuant to the National Housing Act intended to assist lower income families, (a)(1) is satisfied because unsubsidized projects, by their very own terms, no longer meet a need for rental housing for lower income families. These projects have no income limitation restrictions or income verification procedures, nor do they have mechanisms in place to assure affordable rental housing for lower income families. To the extent these projects or their tenants receive other HUD rental assistance for low-income affordability, e.g., Section 8, such other assistance is not dependent on the existence of a regulatory agreement, thereby leaving tenants receiving Section 8 unaffected after the prepayment.
2. **Scenario #2.** Section 250(a)(1) can be satisfied if owners of projects subsidized² under the

² The following properties are subsidized under the National Housing Act and are intended to meet the needs for rental housing for lower income families. All other projects not listed below are deemed to be unsubsidized for the purpose of Section 250 discussion and for reasons discussed in the Background portion of this Notice.

- 1) A property with a mortgage insured under Section 236 or 221(d)(3) BMIR with a Non-Profit owner.
- 2) A property with a mortgage insured under Section 236 or 221(d)(3) BMIR with a Limited Dividend owner that is within 20 years from final endorsement.
- 3) A property with a mortgage insured under Section 236 or 221(d)(3) BMIR, that was transferred from a Non-Profit owner to a Limited Dividend owner and the Mortgage Note was not amended or modified.

National Housing Act can show that the buildings covered by the insured mortgage sought to be prepaid is/are no longer needed as a source of low-income housing in the community. The local HUD field office must make this determination and indicate the basis if there is no longer a need for rental housing for lower income families (e.g., does the local public housing authority have a waiting list?). In such cases, the owner of the housing project may prepay the mortgage and be free and clear of any further commitments to HUD, other than those imposed by a Section 8 contract should the housing project be subject to one. The owner will not be required to place any rental restrictions on the property or maintain the housing for lower income tenants.

3. **Scenario #3.** Section 250(a)(1) can be satisfied if the owner of a subsidized project can show that the regulatory agreement executed by the owner as part of the mortgage insurance transaction is no longer needed by assuring that the building will continue to provide low-income housing in the absence of any regulatory agreement. In these cases, HUD will permit a prepayment in order to recapitalize the project only if the owner agrees to execute a Use Agreement that ensures that the project will continue to be maintained as rental housing for lower income families in the area until at least the date the original mortgage would have terminated had it not been prepaid. The Use Agreement provides the mechanism for ensuring that the building will continue to operate as low-income housing after the prepayment. It requires the project to maintain the same affordability and rental restrictions as those that were in place before the prepayment and minimize the threat of a negative impact on current and future low-income tenants. The owner must have the Use Agreement recorded against the property, and provide copies of that Use Agreement, when signed, to applicable State and local governments, and to the local public housing authority.

Section 250(a)(2) Notice Requirements

As noted above, Section 250(a)(2) requires the Secretary to (A) determine that the owner has notified the tenants of the owner's request for approval of prepayment, (B) the tenants are provided with an opportunity to comment on the owner's request, and (C) the tenants' comments are taken into consideration. HUD has determined that a letter similar to that provided in Attachment 1 to this Notice, when delivered to each occupied unit in the affected property, and prominently posted at each building in the affected property, will satisfy the notice requirement of Section 250(a)(2)(A).

A copy of the letter to the tenants must be provided to the HUD field office with jurisdiction over the property and to the head of the unit of local government. The following certification must accompany delivery of the copy of the letter to the tenants to the HUD field office: "I hereby state, pursuant to 18 U.S.C. § 1001, that I have properly delivered copies of the notice to the tenants in the property described in that notice." A sample certification is at Attachment 1-A. The owner or owner's representative must sign this certification.

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- 4) A property with a Rent Supplement Contract.
 - 5) A property with a Flexible Subsidy loan, that contained a 40-year restriction against prepayment without prior HUD approval, and where the Financial Assistance Contract contains paragraph 17 regarding preserving affordability of the project until the original mortgage term.

To comply with Section 250(a)(2)(B), the name, address, and telephone number of the HUD project manager must be given on the back of the form as the point of contact for tenant questions and comments. To comply with Section 250(a)(2)(B), any comments and questions must be reviewed by HUD field office staff prior to making the determinations, described in the section immediately below, to the Office of Asset Management in Headquarters.

Additionally, the Department's prepayment notice requirements do not exempt owners from any applicable state and locality-specific notice requirements.

Section 250(a)(3) Relocation Plan

Subsection (a)(3) requires that the Department ensure that there is a plan for providing relocation assistance to adequate, comparable housing for lower income tenants displaced as a result of prepayment.

Scenarios 1 and 2 of the Section 250(a)(1) discussion cover prepayment requests for projects where a finding has been made that the project no longer meets the need of low-income rental housing. These include cases where the prepayment request is intended to lead to the demolition of the property or to its conversion to another use so that it will no longer be used to supply affordable rental housing. In such cases, the owner must present a prepayment proposal to HUD with sufficient justification for HUD staff to determine 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.

This proposal must include, at a minimum, information about the number of tenants currently being housed at the property, the waiting list if any, the amount and location of alternative sources of affordable rental housing in the immediate neighborhood of the property, and the vacancy rate at those alternative properties. The owner must also supply a detailed plan for relocating all potential affected tenants, evidence of notice to the tenants as provided for above, and consideration of tenant comments, evidence of Notice of the proposal to the head of the unit of general local government, and any further information required by HUD to make this determination.

Under Scenario 3 (prepayment requests where there is still a need for low-income rental housing that is satisfied through the execution of a Use Agreement), the Department will only permit prepayment if no current tenants are displaced as the result of the prepayment. Hence, no relocation plan is required.

Use Agreement Requirements

Owners must obtain the appropriate Use Agreement from their local HUD field office. HUD and the owner must execute the appropriate Use Agreement prior to or at closing of the prepayment (proof of recordation must be submitted to the local HUD Multifamily Hub or Program Center). Proof of recordation is a condition of HUD prepayment approval and release of the regulatory agreement.

Use Agreement Rent Restrictions

- 1) If a unit is covered by a Section 8 Housing Assistance Payments (HAP) Contract, rents will be determined in accordance with HAP Contract requirements, including any future changes that govern such contract. If a project's Regulatory Agreement requires the Owner to agree to accept any offer by the Secretary to renew the HAP contract so long as the mortgage covering the project is insured or held by the Secretary, the Use Agreement must include a provision requiring the owner to agree to accept any offer by the Secretary to renew the HAP contract (or any successor program) for the term of the Use Agreement.
- 2) For non-Section 8 units, the rent is restricted to an Initial Rent level, as adjusted by an Area Median Income Factor. The Initial Rent is to be set as follows:
 - a) If no rehabilitation or project improvements are planned, the Initial Rent should equal the current rent levels prior to prepayment.
 - b) If the owner is prepaying in order to refinance and complete a rehabilitation of the property, a rent increase based on the new financing may be considered and processed by the Project Manager. The rent increase should be processed in accordance with Chapter 7 of the 4350.1 and the proposal should include a detailed description of the planned rehabilitation. The budget based rent calculation may not be used where an immediate equity "takeout" is proposed or where the purchase price for the project is above market comparables.
- 3) In addition to providing a budget-based rent increase proposal, the owner must also submit a narrative of how tenants will be protected from any rent increases due to the proposed transaction. This narrative must address what subsidies, such as Section 8 Vouchers, LIHTC equity, and bond financing, will be provided as part of the transaction. Special care should be given to the use of other subsidies. The income limitations of the other subsidy programs might cause the involuntary displacement of existing residents, which is unacceptable.

For example, projects that will use LIHTC must meet use requirements under the LIHTC program. Specifically, on the day the units are "placed in service" under the LIHTC program, each tenant must be eligible for occupancy under the LIHTC income limits established for the project. To maximize the tax credit value, any tenant over the income limits on the day the project is "placed in service" may be requested to vacate the project. Therefore, to avoid displacement, it might be prudent for an owner to include less than 100% of the units under the LIHTC program, thereby giving the project room to retain tenants ineligible for LIHTC units. A detailed tenant income survey should be completed to permit everyone to know the impact of the proposed transaction on existing residents.

- 4) Initial Rents may not, under any circumstances, exceed 30% of 80%(95% for BMIRs) of median income, as adjusted for family and bedroom size.

All project specific information must be inserted into the Use Agreement where indicated. Once the Use Agreement has been completed, the Project Manager must forward it to the local Office of General Counsel for review.

Once Counsel has approved the final document, the owner should submit a fully executed copy of the Use Agreement along with an Attorney's Opinion that the Use Agreement will be recorded in the first position, superior to all other liens.

Upon the receipt of these items, and approval of the prepayment by the Office of Multifamily Asset Management (Asset Management) in Headquarters, the Use Agreement can be executed by the Hub Director/Program Center Director.

After recording, the owner must provide the Field Office with a recorded copy of the Use Agreement within 2 business days. HUD will not issue a release of the regulatory agreement until all Use Agreement recording requirements have been satisfied.

REMS

The Project Manager must assure that information about the prepayment is put into the Real Estate Management System (REMS) in order to track and monitor Use Agreements.

A REMS screen has been developed to allow for the following information to be recorded and tracked:

1. Ability to record reasons for restrictions of Agreement
2. Record number of units that must be maintained by property (Use Restricted)
3. Record effective and expiration dates
4. Provide (for HUD's) use a termination date
5. Explanation for why Agreement was terminated
6. Ability to record if owner is compliant with terms
7. Ability for owner to certify compliance annually electronically
8. Ability to record why owner is not in compliance – include a text box with description
9. Ability to record history of annual compliance
10. History of when Agreement was recorded in the System
11. Ability to record multiple agreements on a given property

Headquarters Processing of Prepayment Requests

The Office of Multifamily Asset Management must approve all prepayments, unless the prepayment is part of a restructuring in the Office of Affordable Housing Preservation (OAHP). When a prepayment request is received in Asset Management, staff in that office send a Prepayment Checklist to the Multifamily Program Center (PC)/Hub with jurisdiction over the property. That office must gather and review all documents in the checklist and provide the Office of Asset Management with the PC/Hub recommendation on whether or not to approve the prepayment request. The Prepayment checklist has been modified to conform to the conditions provided for in this Notice.

Once the checklist and required documentation is received from the PC/Hub, it is reviewed and either approved, approved with conditions, such as a requirement for a Use Agreement, or not approved, with reasons provided for the disapproval.

Questions

Questions about this Notice should be addressed to the Office of Multifamily Asset Management.

Brian D. Montgomery
Assistant Secretary for Housing-Federal
Housing Commissioner

Attachment A
Appendix 1

This Attachment is intended to assist owners who plan to prepay a HUD-held/insured mortgage on any of the following types of property and still maintain the property as affordable housing:

1. A property with a mortgage insured under Section 236 or 221(d)(3) BMIR with a Non-Profit owner.
2. A property with a mortgage insured under Section 236 or 221(d)(3) BMIR with a Limited Dividend owner that is within 20 years from final endorsement.
3. A property with a mortgage insured under Section 236 or 221(d)(3) BMIR, that was transferred from a Non-Profit owner to a Limited Dividend owner and the Mortgage Note was not amended or modified.
4. A property with a Rent Supplement Contract.
5. A property with a Flexible Subsidy loan, that contained a 40-year restriction against prepayment without prior HUD approval, and the Financial Assistance Contract contains paragraph 17 regarding preserving affordability of the project until the original mortgage term.

In order to comply with 250(a) the mortgagor must:

- Notify the tenants of his/her intent to prepay, using the model letter found in Appendix 1.
- If the mortgagor is prepaying in order to refinance and complete a rehabilitation of the property, a rent increase based on the new financing may be considered and processed by HUD in accordance with Chapter 7 of the 4350.1 and the proposal must include a detailed description of the planned rehabilitation.
 - The budget based rent calculation cannot be used where an immediate equity “takeout” is proposed or where the purchase price for the project is above market comparables.
 - In addition, when submitting a budget-based rent increase proposal, the mortgagor must also submit a narrative of how tenants will be protected from any rent increases due to the proposed transaction, and include this information in the mortgagor’s notification to the tenants. This narrative must address what subsidies, such as Section 8 Vouchers, LIHTC equity, and bond financing, will be provided as part of the transaction.
 - **Special care must be given to the use of other subsidies.** The income limitations of the other subsidy programs might cause the involuntary displacement of existing residents, which is unacceptable.
 - For example, projects that will use LIHTC must meet use requirements under the LIHTC program. Specifically, on the day the units are “placed in service” under the LIHTC program, each tenant must be eligible for occupancy under the LIHTC income limits established for the project. To maximize the tax credit value, any tenant over the income limits on the day the project is “placed in service” may be requested to vacate the project. Therefore, to avoid displacement, it might be prudent for a mortgagor to

include less than 100% of the units under the LIHTC program, thereby giving the project room to retain tenants ineligible for LIHTC units. A detailed tenant income survey should be completed to permit everyone to know the impact of the proposed transaction on existing residents.

- The notification letter must be delivered to each occupied unit and posted in the project office and at least 3 prominent locations on the project site, and
- A copy of the notification letter must be sent to the head of the unit of general local government.
- Make available in the project office during normal business hours, for all the tenants, a copy of the proposed Use Agreement (contact the local HUD Office to obtain the appropriate Use Agreement) that the owner plans to sign with HUD.
- Offer the tenants a 30 day period in which to consider and provide the owner with comments on the proposed prepayment and Use Agreement, and
- Consider the tenants' comments, making any adjustments in the plan deemed appropriate by the owner, and
- Forward to the HUD field office with jurisdiction over the property
 - A copy of the letter to the tenants and the head of the unit of general local government,
 - Copies of all comments received, and
 - The owner's response to the comments received.

Attachment 1

**150-Day Notification Letter to Tenants When Owner Prepays Mortgage on a
Non-Preservation Eligible Project**

Date _____

Dear Resident:

I/We the Owner(s) of **[Name of Project]** have decided to pay back (or terminate) the loan for this property. The Secretary of the Department of Housing and Urban Development (HUD) requires that owners provide at least a 150-day notice to HUD, the State or local government, and to each tenant of their intent to prepay or terminate their mortgage. This letter meets that requirement by notifying you that we intend to prepay or terminate our mortgage held or insured by HUD effective on **[Date: At least 150 days from the date of this letter]**. If you have comments, please submit them to the office located at **[Location of project office]** no later than 30 days from the date of this letter. All comments will be reviewed and, where appropriate, a response will be provided. Prepayment of the mortgage could result in an increase in rent.

I/We have notified HUD of our intent to prepay or terminate our mortgage.

If you have any questions, please call the on-site property manager at **[On-site project manager's address or owner's contact/representative]**. For additional information, you may also contact **[Local HUD Office]** at **[Office phone number]**.

Sincerely,

Owner

cc:Local HUD Office
Local Government Offices

OWNER CERTIFICATION

I/We hereby certify, pursuant to 18 U.S.C. S1001, that I/We have properly delivered copies of the tenant notification to the tenants in the property located at [**Insert property address**].

Owner or Owner's Representative

Date _____