CHAPTER 14. PARTIAL PAYMENTS OF CLAIMS

SECTION 1. GENERAL INFORMATION

A large number of HUD Insured mortgages throughout the country are nonperforming because of circumstances beyond the control of the owner. When the owner has defaulted on an insured mortgage, it may be in HUD's best interest to pay a Partial Payment of Claim (PPC) and hold a second mortgage with terms that allow the owner to pay the second mortgage in increasingly larger stages as the project's cash flow improves.

The process starts when the mortgagee elects to assign an insured mortgage under 24 CFR 207.258 to the Department. At this point, the owner may request the Director of the Housing Management Division in the HUD Field Office to request the mortgagee to consider a PPC as an alternative to a full payment of claim (see letter in appendix 1). The mortgagee must voluntarily agree to accept a partial payment of the insurance claim before the processing of the proposal may begin.

If the mortgagee agrees to accept a PPC, the owner must submit a proposal in accordance with this handbook guidance to the Field Office for review. All proposals, together with the Field Office's recommendations, will be sent to HUD Headquarters.

The applicable regulation for PPC is 24 CFR Part 207.258b titled: Partial Payment of Claim (see appendix 2).

14-1. PROJECTS THAT ARE ELIGIBLE

A. Section 207: Multifamily Housing Mortgage Insurance

B. Section 213: Cooperative Housing Mortgage Insurance

C. Section 220: Mortgage Insurance for Urban Renewal

D. Section 221(d): Low cost and moderate income mortgage insurance: Except for coinsured or formerly coinsured

E. Section 223(f): Except for coinsured or formerly coinsured

4350.1 REV-1

14-2. PROJECTS THAT ARE NOT ELIGIBLE

A. 24 CFR Part 232: Nursing Homes, Intermediate Care Facilities

B. 24 CFR Part 234: Condominium Ownership Mortgage Insurance

C. 24 CFR Part 236: Mortgage Insurance and Interest Reduction Payment for Rental Projects

D. 24 CFR Part 242: Hospitals

E. 24 CFR Part 244: Group Practice Facilities

F. 24 CFR Part 251: Coinsurance for the Construction or Substantial Rehabilitation of Multifamily Housing Projects

G. 24 CFR Part 255: Coinsurance for the Purchase or Refinancing of Existing Multifamily Housing Projects (i.e., projects coinsured under 223(f).

H. Formerly coinsured projects that have been converted to full insurance under 207 including 221(d).

14-3. REGULATORY REQUIREMENTS

The Director of the Housing Management Division should request the mortgagee to participate in a PPC in lieu of assignment as soon as practicable. Normally this request can be made when a default has occurred and a reinstatement is unlikely. At the same time, the Housing Management Division must discuss the possibility of a PPC with the owner. In addition, the following findings must be made:

1. The mortgagee is entitled, after a default under 207.255, to assign the mortgage in exchange for the payment of insurance benefits;

2. The relief resulting from partial payment when considered with other resources available to the project would be sufficient to restore the financial viability of the project;

3. The project is or can (at reasonable cost) be made structurally sound;

4. The management of the project is satisfactory as demonstrated by a rating of at least satisfactory on the most recent management review;

5. The default under the insured mortgage was beyond the control of the owner;

6. The project is, or potentially could serve as a low and moderate income housing resource;

7. The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and other liens approved by the Commissioner;

8. The mortgagee has voluntarily agreed to accept PPC under the mortgage insurance contract and to recast the remaining mortgage amount under terms and conditions prescribed by the Commissioner;

9. The owner has agreed to repay to the Commissioner an amount equal to the partial payment, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the Commissioner. The terms of the second mortgage will be determined on a case-by-case basis to assure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast insured mortgage. The Commissioner may provide for postponed amortization of the second mortgage.

SECTION 2. OWNER'S PROPOSAL.

14-4. REQUIREMENTS

A. The owner must demonstrate the regulatory requirements in paragraph 14-3.

B. The owner made a net capital contribution equal to 5% or more of the original mortgage to fund operating shortfalls since final endorsement (for nonprofit its in-kind services acceptable to FO).

C. The owner has remitted all net cash to the mortgagee between the date of default and the date of closing of the PPC.

14-5. PROPOSAL SUBMITTED BY THE OWNER

The owner in making a request shall provide to the Field Office:

A. A cover letter stating the parameters and conditions of the owner's request. The owner must provide:

   1. The amount of the PPC desired (broken down into the two amounts: principal and deferred interest);

   2. An anticipated closing date;

   3. A discussion of the problem(s) causing the default;

   4. Steps taken to overcome both past and present problem(s).

B. Substantiate the amount of net capital contributions, e.g., a certified statement by an Independent Public Accountant (IPA) or a Certified Public Accountant (CPA) showing advances and repayments to the owner. This statement could include, but is not limited to the following:

   1. Contributions/advances made since final endorsement for the project's operating expenses.

   2. Distributions made to the owner since final endorsement.

   3. Repayment of advances since final endorsement.

   4. The total net advances.

C. A current cash flow analysis and proforma statement using Form HUD-92547-A, Budget Worksheet Income and Expense Projections.

D. A cash flow projection and Net Operating Income (NOI) for 10 years.

E. A review of the last HUD Management Review and Physical Inspection Report. If the project received a less than satisfactory rating in any section, the owner must provide written comments regarding the status of corrective action in progress, i.e., what repairs are completed and target dates for completion of others.

F. Current rent roll showing units occupied and rents charged for each unit.

G. A certification as to whether the owner is or will be participating in Low Income Housing Tax Credits (LIHTC). Refer to Notice H-91-18 and include HUD Form 2880 (Applicant Recipient Update Report)

SECTION 3. FIELD OFFICE REVIEW

The Loan Management Branch (LMB) will review the owner's proposal and request additional information to resolve any questions prior to submission to Headquarters. All recommendations, analysis and findings are sent to the Office of multifamily Housing Management, Operations Division.

14-6. FIELD OFFICE ANALYSIS

The Director of Housing Management will recommend either approval or rejection of the PPC to HUD Headquarters based on the following:

A. Determine that the regulatory requirements are met. The regulatory requirements are listed in paragraph 14-3.

B. Determine the owner's contribution ratio. The contribution ratio is calculated by dividing the net capital contributions by the original mortgage balance of the insured mortgage. The owner's contribution ratio must equal or exceed 5%.

The owner's contributions must be verified by LMB by reviewing the project's financial statements.

C. Determine base year expenses, income, vacancy rate and Net Operating Income (NOI). The LMB must review the project's base year income, expenses, vacancy rate and NOI submitted by the owner and make adjustments where necessary. The base year NOI is a function of three variables.

Expenses: Review historical data and data available on similar projects in the same market area. This process is similar to the review of an owner's request for a budgeted rent increase.

Vacancy rate: Verify vacancy rate by reviewing the current rent roll and comparing these rents to the approved rent schedule.

Also, consider concessions and rent reductions the owner may have employed to increase the physical occupancy of the project. Due to these concessions the project may have a reasonable level of units occupied, but the actual rents may be below the level necessary to pay all expenses and debt service.

Income: Verify that income is appropriate for the project considering the market conditions in the area.

D. Determine validity of owner's assumptions and projected performance (IO year projection assumptions) The LMB staff may obtain estimates from the Economic and Market Analysis Section (EMAS) and Valuation Branch (VAL). It is emphasized that the project will have problems that are unique and may require fine tuning of these estimates.

E. Determine the maximum PPC Principal The PPC Principal amount equals the lesser result of the two tests stated below. However, HUD will not approve a PPC Principal greater than 50% of the Unpaid Principal Balance (UPB). Use the worksheet in Appendix 3 to calculate the PPC Principal. Below is an explanation of the two tests:

1. Test one: Three times the owner's net capital contributions.

2. Test two: The amount of the current mortgage that is not supportable by the Net operating Income.

F. Determine principal Ratio. This ratio is determined by dividing the maximum PPC Principal by the Unpaid Principal Balance (UPB).

G. Determine the amount of delinquent interest to be paid by HUD. In general, HUD will pay a percentage of delinquent interest equal to the Principal Ratio. The amount paid by HUD at the closing will be added to the second mortgage.

HUD will pay more of the delinquent interest in order to encourage a higher level of net capital contributions. This occurs when the contribution ratio falls within the following percentages:

Contribution Ratio	HUD's share of delinquent interest
7%-9.99	HUD will pay delinquent interest equal to the Principal Ratio plus 50% of the remaining delinquent interest
10%-15.99%	HUD will pay 100% of the delinquent interest
16% and over	HUD will pay 100% of delinquent interest and will reduce its equity kicker by 15%. The equity kicker will not be reduced lower than 5%.

H. Determine estimated debt service deficit. The owner must provide cash escrow or letter of credit in the amount of the estimated deficit which may result in the event the project and mortgage expenses exceed project income. The calculation of the escrow amount should take into consideration the following:

1. The total payment on the insured first mortgage is not fully covered by NOI; or

2. The total service charge on the second mortgage is not covered by the remaining NOI; or

3. The Minimum Monthly Payment (MMP) of interest on the second (MMP is a condition of the approval) is not covered by NOI available after paying 1 and 2 above; or

4. The debt service on the recast second mortgage is not covered in full by available NOI.

I. Determine Equity Kicker. Divide the amount of PPC (principal) by the Unpaid Principal Balance (UPB) of the delinquent mortgage.

14-7. Field Office Findings.

A. The project is or can (at reasonable cost be made structurally sound, and the management of the project is satisfactory. Provide copies of the latest management review and physical inspection report. If the rating on the management review or the physical inspection report is below satisfactory in any related section, provide a copy of the owner's plan(s) for corrective action.

B. The default under the insured mortgage was beyond the owner's control. Loan management may complete a Failing Project Checklist (HUD 5815) to assist them in making their decision.

C. The project covered by the mortgage is free and clear of all liens other than the insured first mortgage and such other liens as the Commissioner may have approved. (An updated title policy must be reviewed prior to closing.)

D. Other options for solving the project's problems have been explored and have been found not to work (e.g., refunding of tax exempt bonds, relief from the local government agency, Section 8 assistance, flexible subsidy, etc.)

E. The relief resulting from the partial payment when considered with other resources available to the project will be sufficient to restore the financial viability of the project (provided the projections materialize).

F. The project is or potentially could serve as low and moderate income housing.

SECTION 4. APPROVAL AND REJECTION LETTER

All decisions made by Headquarters are final.

14-8. APPROVAL LETTER

If the PPC meets the foregoing requirements, Headquarters will forward an approval letter along with a set of terms and conditions to the owner.

14-9. REJECTION LETTER

If the PPC does not meet the forgoing requirements, Headquarters will forward a rejection letter to the owner.

SECTION 5. CLOSING AND POST CLOSING REQUIREMENTS

14-10. REQUIRED CLOSING DOCUMENTATION AND REVIEW

Ten days prior to the closing date the owner is required to submit two full sets of the legal documentation (one set to HUD Headquarters and one set to the appropriate Field Counsel). Failure to submit the closing documents 10 days prior to the closing will delay the closing. Legal documents must be submitted in an acceptable format and must include all required documents.

The Field Counsel will review the legal documents for accuracy and submit to Headquarters, Office of Multifamily Housing Management, for execution.

The following is a list of legal documents that are generally required. The list is not limited to the following:

a. Modification of Mortgage Note and Mortgage
b. Second Mortgage Note and Mortgage
c. Second Mortgage with Rider
d. Second Regulatory Agreement
e. An Agreement to Share Proceeds (equity kicker)
f. Certification of Current Mortgage
g. Certification of Mortgage Balance
h. Letter of credit custodial agreement, Letter of credit and Sight Draft
i. Updated Title Binder

14-11. SCHEDULING THE CLOSING

Headquarters will determine the closing date. The owner should request a specific date(s) for the closing. However, Headquarters has the final authority to set the closing date. The owner's requested dates will be accommodated whenever possible.

14-12. OWNER'S COMPLIANCE

The HUD-Held mortgage should be serviced in accordance with Chapter 10 to Handbook 4350.1, titled HUD-Held Servicing, e.g., Owners must submit net cash and monthly accounting statements.

LETTER OFFERING PARTIAL PAYMENT OF CLAIM

Dear :

We have your letter of _________________________ giving notice of the mortgagee's election to assign the mortgage on ________________ (Project No.___________) in___________________ to the Secretary for payment of mortgage insurance benefits. The mortgage on this project may be eligible for a partial payment of claim in lieu of assignment.

If the mortgage is eligible, and the mortgagee agrees to accept a partial payment, forms and instructions for processing the claim will be sent to you by HUD's Office of General Counsel and Office of Mortgage Insurance Accounting and Servicing. In the event the mortgagee chooses not to accept the partial payment, we will proceed with a full assignment of the mortgage.

In the interim, the mortgagee must continue to take whatever actions are necessary to protect the Secretary's interest in the mortgage and continue to bill for and accept all payments. (The payments should not be applied to the indebtedness.)

The mortgagee's willingness to accept a partial payment of claim should be indicated by the signature of an authorized official in the space provided below. The letter should be

returned to this office to the attention of ____________________.
If further information is required, ___________________ should be contacted on ___________.

Sincerely,

Agrees, on behalf of mortgagee, to accept a partial payment of claim if the mortgage is eligible.

Name: ___________________________ Date: ________________

Title: __________________________

207.258b Partial payment of claim,

(a) Whenever the Commissioner receives notice under 207.258 of a mortgagee's intention to file an insurance claim and to assign the mortgage to the Commissioner, the Commissioner may request the mortgagee, in lieu of assignment, to accept partial payment of the claim under the mortgage insurance contract and to recast the mortgage, under such terms and conditions as the Commissioner may determine.

(b) The Commissioner may request the mortgagee to participate in a partial payment of claim in lieu of assignment only after a determination that partial payment would be less costly to the Federal government than other reasonable alternatives for maintaining the low- and moderate-income character of the project. This determination shall be based upon the findings listed below and such other findings as the Commissioner deems appropriate:

(1) The mortgagee is entitled, under 207.255, to assign the mortgage in exchange for the payment of insurance benefits;

(2) The relief resulting from partial payment, when considered with other resources available to the project, would be sufficient to restore the financial viability of the project;

(3) The project is, or can at reasonable

cost be made, structurally sound;
(4) The management of the project is satisfactory to the Commissioner; and
(5) The default under the insured mortgage was beyond the control of the mortgagor.
(c) Partial payment of a claim under this section shall be made only when:

(1) The project is, or potentially could serve as a low- and moderate-income housing resource;
(2) The property covered by the mortgage is free and clear of all liens other than the insured first mortgage and such other liens as the Commissioner may have approved;
(3) The mortgagee has voluntarily agreed to accept partial payment of the insurance claim under the mortgage insurance claim and to recast the remaining mortgage amount under terms and conditions prescribed by the Commissioner; and
(4) The mortgagor has agreed to repay to the Commissioner an amount equal to the partial payment, with the obligation secured by a second mortgage on the project containing terms and conditions prescribed by the Commissioner. The terms of the second mortgage will be determined on a case-by-case basis to assure that the estimated project income will be sufficient to cover estimated operating expenses and debt service on the recast insured mortgage. The Commissioner may provide for postponed amortization of the second mortgage.
(d) Payment of insurance benefits under this section shall be in cash. The Commissioner shall waive the deduction of one percent of the mortgage funds advanced to the mortgagor, provided for in 207.259(b)(2)(iv), with respect to a partial payment of a claim under this section. The items referred

to in   207.258(b)(4) shall either be
retained by the mortgagee or delivered
to the Commissioner in accordance
with instructions to be issued by the
Commissioner with respect to a partial
payment of claim under this section.
50 FR 38786, Sept. 25, 1985

PARTIAL PAYMENT OF CLAIM WORKSHEET

PROJECT NAME:________________________________
PROJECT NO:________________________________

I. DETERMINATION OF MAXIMUM ALLOWABLE PARTIAL PAYMENT OF CLAIM

Round all numbers to the nearest dollar.

The maximum allowable PPC is the lesser of test one or two but not more than 50% of unpaid principal balance (UPB).

LIMITATION:

_________________ X .5 = ___________________________
Current UPB PPC limit

Test one: Three times owner's contribution (since final endorsement). See paragraph 14-5B of this handbook guidance.

a. total owner contributions\ advances ________________

b. amount repaid ________________

c. net owner contributions\ advances (a minus b) ________________

Multiply net owners contribution/advances by three X 3

result of test one ______________

Test two: Calculates the amount of current mortgage which cannot be supported by current cash flow.

a. Net Operating Income (NOI) ___________________
See paragraph 14-6C of this

handbook for guidance

b. enter MIP
(MIP is current UPB x .005) ________________

c. subtract MIP from NOI ________________

d. multiply "c" by 0.9 ________________
(this equals net NOI)

e. divide result in "d" by
the *debt services constant of the
interest rate. The result
is the mortgage amount
supportable by "Net" NOI ________________

* The Debt Service constant may be obtained from the
Valuation Branch in Housing Development.

f. current UPB of the delinquent
mortgage ________________

g. enter supportable mortgage
(supportable mortgage is "e"
above) ________________

Subtract supportable mortgage
from the current UPB
(f minus g)

result of test two ________________

II. DEBENTURE RATE DETERMINATION
(USE THE FHA DEBENTURE RATE CHART)

The highest debenture rate below is used to calculate
delinquent interest.

1. firm commitment date __/__/__
debenture rate _____%
2. initial Endorsement date __/__/__
debenture rate _____%

III. ESTIMATE THE DELINQUENT INTEREST TO BE PAID BY HUD

1. unpaid principal balance ________________

2. debenture rate

(higher rate of 1 or 2 above) ______________

3. annual interest rate (multiply line 1 by line 2) ______________

4. number of days in default year (365 or 366 days) ______________

5. daily interest (divide line 3 by line 4) ______________

6. number of days from date of default to anticipated date of closing minus 1 (HUD does not pay interest for the day of closing) ______________

7. total interest (multiply line 5 by line 6) ______________

8. contribution ratio (see paragraph 3-1B) ______________

9. principle ratio (see handbook paragraph 3-1 F) ______________

10. Delinquent interest paid by HUD at the closing (multiply line 7 by line 8) ______________

11. plus additional interest paid by HUD at the closing (see handbook paragraph 3-1G)

    a. total delinquent interest (line 7) ______________

    b. interest paid by HUD (line 10) ______________

    c. remaining interest ______________

    d. percentage of additional interest paid by HUD (see paragraph 3-lG) ______________

    e. multiply c by d ______________

12. total interest payable by HUD

(add line 10 and line 11e) ______________

IV. ESTIMATE AMOUNT OF SECOND MORTGAGE

1. Maximum allowable PPC (Lowest amount of test one or test two or the limitation) ______________

2. amount of delinquent interest paid by HUD at the closing ______________

3. total principal of second mortgage ______________

FHA DEBENTURE INTEREST RATE TABLE

The interest rate applicable to debentures issued under all provisions of the National Housing Act, except Section 221 (g)(4), is the rate in effect on the date that the commitment to insure the loan or mortgage was issued, or the date that the loan or mortgage was initially endorsed for insurance, whichever rate is higher. Following are the effective rates:

On or after	On or After
July 1, 1966------4/5/8	January 1,1985------11 5/8
January 1, 1967---4 3/4	July 1, 1985--------11 1/8
January 1, 1968---5 3/8	January 1, 1986-----10 1/4
July 1, 1969------5 7/8	July 1,1986----------8 1/4
January 1, 1970---6 3/8	January 1, 1987------8
July 1, 1970------6 7/8	July 1, 1987---------9
January 1, 1971---6 1/8	January 1, 1988------9 1/8
July 1, 1971------5 7/8	July 1, 1988---------9 3/8
January 1, 1972---5 3/8	January 1, 1989------9 1/4
July 1, 1972------5 1/2	July 1,1989----------9
January 1, 1973---5 1/4	January 1, 1990------8 1/8
July 1, 1973------6	July 1, 1990---------9
January 1, 1974---6 1/4	January 1, 1991------*

July 1, 1974------6 7/8
July 1,1975-------7
January 1, 1976---7 1/8
July 1, 1976------7
January 1, 1977---6 5/8
July 1, 1977------7 1/4
January 1, 1978---7 1/8
July 1, 1978------7 3/4
January 1, 1979---8
July 1, 1979------8 1/4
January 1, 1980---9 1/2
July 1, 1980------9 7/8
January 1, 1981--11 3/4
July 1, 1981-----12 7/8
January 1, 1982--12 3/4
January 1, 1983--10 1/4
July 1, 1983-----10 3/8
January 1, 1984--11 1/2
July 1, 1984-----13 3/8

* After January 1, 1991, this debenture rates table should be updated as the FO receives additional rates.