

(iii) *Credit enhancement from non-FHA sources.* If credit enhancement is to be provided by a non-FHA source under section 517(b)(4) of MAHRA, HUD will consider waiver of any non-statutory provision in this part only if the waiver will not materially impair achievement of the purposes of MAHRA and if the waiver is essential to meet the legitimate business or legal requirements of the provider of credit enhancement.

§ 401.461 HUD-held second mortgage.

(a) *Amount.* (1) The Restructuring Plan must provide for a second mortgage to HUD whenever the Plan provides for either payment of a claim under section 541(b) of the National Housing Act (541(b) claim) or the modification or refinancing of a HUD-held first mortgage that results in a first mortgage with a lower principal amount. The term “second mortgage” in this section also includes a new HUD-held first mortgage (not a refinancing mortgage), if a full payment of claim is made under § 401.471 or if a full payment of claim is unnecessary because surplus project accounts are available to facilitate the Restructuring Plan, pursuant to section 517(b)(6) of MAHRA, or if § 401.460(a) does not permit a restructured first mortgage in any amount.

(2) The second mortgage must be in a principal amount that does not exceed the lesser of:

(i) The amount the PAE reasonably expects to be repaid based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the property; and

(ii) The greater of:

(A) The section 541(b) claim (or the difference between the unpaid principal balance on HUD-held mortgage debt immediately before and after the restructuring), plus surplus project accounts from residual receipts accumulated pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e) and derived from an expiring Section 8 Housing Assistance Payments contract and not otherwise distributed to the owner and made available to facilitate the Restruc-

turing Plan pursuant to section 517(b)(6) of MAHRA, and

(B) The difference between the unpaid balance on the first mortgage immediately before and after the restructuring.

(b) *Terms and conditions.* (1) The second mortgage must have an interest rate of at least one percent, but not more than the applicable Federal rate.

(2) The second mortgage must have a term concurrent with the modified or refinanced first mortgage, if any. HUD may provide that if there is no first mortgage, the second mortgage may continue for a term established by HUD.

(3)(i) Principal and interest on the second mortgage is payable only out of net cash flow during its term. “Net cash flow” means that portion of project income that remains after the payment of all required debt service payments on the modified or refinanced first mortgage, if any, including payment of any past due principal or interest, and payment of all reasonable and necessary operating expenses (including deposits to the reserve for replacement account) and any other expenditure approved by HUD.

(ii) The priority and distribution of net cash flow is as follows:

(A) HUD or the PAE may approve the payment to the owner of up to 25 percent of net cash flow based on consideration of relevant conditions and circumstances including, but not limited to, compliance with the management standards prescribed in § 401.560 and the physical condition standards prescribed in § 401.558; and

(B) All remaining net cash flow will be applied to the principal and interest on the second mortgage, until paid in full, and then to any additional subordinate mortgage under § 401.461(c).

(4) HUD may cause the second mortgage to be immediately due and payable on the grounds provided in section 517(a)(4) of MAHRA, including an assumption of the mortgage in violation of HUD standards for approval of transfers of physical assets (if applicable), or if the owner materially fails to comply with other material HUD requirements after a reasonable opportunity for the owner to cure such failure. A decision by HUD in this regard is subject to the

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administrative appeals procedure in subpart F of this part, unless HUD acts on the basis of the grounds specified in sections 517(a)(4)(A) or (B) of MAHRA.

(5) HUD will consider modification, assignment to the acquiring entity, or forgiveness of all or part of the second mortgage, if: The Secretary holds the second mortgage; and if the project has been sold or transferred to a tenant organization or tenant-endorsed community-based nonprofit or public agency that meets eligibility guidelines determined by HUD; accepts additional affordability requirements acceptable to HUD; and requests such modification, assignment, or forgiveness. A community-based nonprofit group or public agency demonstrates that it is tenant-endorsed in accordance with § 401.480(e).

(c) *Additional mortgage to HUD.* (1) A Restructuring Plan shall require the owner to give an additional mortgage on the project to HUD in an amount that:

(i) For the restructuring of a mortgage insured by HUD, does not exceed the difference between:

(A) The amount of a section 541(b) claim paid under § 401.471 increased by any residual receipts, pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e); and

(B) The principal amount of the second mortgage; or

(ii) For the restructuring of a mortgage held by HUD, does not exceed the difference between:

(A) The principal amount of a restructured HUD-held mortgage and the sum of, as applicable, a restructured HUD-held first mortgage at reduced principal amount, new mortgage funds paid to HUD at closing, and surplus project accounts other than residual receipts, pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e); and

(B) The principal amount of the second mortgage.

(2) HUD may approve a Plan that does not require an additional mortgage, or provides for less than the full difference to be payable under the additional mortgage, or allows for subsequent modification, assignment, or forgiveness of the additional mortgage under any of the following circumstances:

(i) The anticipated recovery on the additional mortgage is less than the servicing costs; or

(ii) HUD has approved modification, assignment, or forgiveness of the second mortgage, pursuant to paragraph (b)(5) of this section.

(3) With respect to the second mortgage required by paragraph (a) of this section, any additional mortgage must:

(i) Be junior in priority;

(ii) Bear interest at the same rate; and

(iii) Require no payment until the second mortgage is satisfied, at which time it will be payable upon demand of HUD or as otherwise agreed by HUD.

[65 FR 15485, Mar. 22, 2000, as amended at 72 FR 66038, Nov. 26, 2007]

§ 401.471 HUD payment of a section 541(b) claim.

HUD will pay a section 541(b) claim from the appropriate insurance fund to the insured mortgagee on behalf of the mortgagor. The mortgagee must use the claim payment to prepay the principal balance of the insured mortgage, in whole or in part, as provided in the Restructuring Plan. All section 541(b) claims will be paid in cash. Part 207 of this title and sections 207(g) and 541(a) of the NA do not apply to a section 541(b) claim.

§ 401.472 Rehabilitation funding.

(a) *Sources of funds—(1) Project accounts.* The Restructuring Plan for funding rehabilitation must include funds from the project's residual receipts account, surplus cash account, replacement reserve account, and other project accounts, to the extent the PAE determines that those accounts will not be needed for the initial deposit to the reserves.

(2) *Debt restructuring.* The Restructuring Plan may provide for funding of rehabilitation through a new first mortgage in conjunction with a payment of a section 541(b) claim. The payment of claim may be in an amount necessary to facilitate the funding of the rehabilitation, by reducing the existing first mortgage debt to make refinancing proceeds available to fund rehabilitation.

(3) *Section 236(s) rehabilitation grant.* The Restructuring Plan may include a