FHA Multifamily Housing Policy Handbook
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UNIT 8 ASSET DEFAULTS, CLAIMS, AND FORECLOSURES

CHAPTER 8.1 DEFAULTS AND ASSIGNMENTS

8.1.1 PURPOSE

This chapter provides information on delinquencies, defaults, and assignments of multifamily loans insured by the Federal Housing Administration (FHA). There are many conditions which may cause a loan delinquency, default, or assignment of the mortgage. Many of these conditions are eliminated as a result of timely recognition by U.S. Department of Housing and Urban Development (HUD) account executives and lenders/servicers, and prompt action by the owner, thus avoiding default or assignment. The action taken varies depending on the type of default and the rights and responsibilities of the lender/servicer, the owner, and HUD, under the related documents, contracts and/or agreements.

8.1.2 APPLICABILITY

This chapter is applicable to FHA-insured loans under any multifamily loan insurance program (defaults on secondary loans are covered in Chapter 8.3, Servicing and Monitoring of HUD-Held Mortgages including M2M Loans of this Handbook). This chapter is not applicable to FHA-insured healthcare loans. Requirements for reporting a notice of default (NOD), submitting an election to assign a defaulted loan to HUD, and assignment of the mortgage on a defaulted loan to HUD are provided in 24 CFR 207.256and 207.258. Additional guidance for HUD staff and lenders' servicing and reporting requirements are located in HUD Housing Handbook 4350.4, *Insured Multifamily Mortgagee Servicing and Field Office Handbook*.

8.1.3 LOAN DELINQUENCIES/DEFAULTS

Loan payments are due on the first day of the month. A loan delinquency occurs when the owner fails to pay any installment payment due under the note and/or mortgage by the specified date when late fees are imposed (refer to loan document(s)).

Regulations in 24 CFR 207.255 define two types of default: fiscal (monetary) and covenant.

A. Fiscal (Monetary) Default

1) A fiscal (monetary) default occurs when the owner fails to pay any installment payment due as set forth in the note and mortgage, including payments due under any operating loss loan. A fiscal default can only result in a mortgage insurance claim if the nonpayment continues for, at a minimum, 30 consecutive days pursuant to 24 CFR 207.255(a)(3) and (b)(3).

2) Loan payments are applied as set forth in the mortgage, and below:

a) mortgage insurance premium (MIP) charges (see 24 CFR Part 207, subpart B);

b) ground rents, if escrowed with lender;

c) taxes;

d) special assessments;

e) water rates;

f) municipal/government utility charges;

g) fire and other property insurance premiums;

h) interest on the note;

i) amortization of principal of the note;

j) reserve for replacements (RfR) funds; and

k) other reserves required by HUD.

3) A loan is considered current if the owner remits enough money to cover items in Section 8.1.3.A.2.a – i above. Failure to cover items j and k is considered a covenant default under the terms of the regulatory agreement.

B. Covenant Default

1) A covenant default occurs when there is a material violation of a covenant of the mortgage. The lender/servicer notifies the owner to take corrective action to remedy the covenant default within a specified time period, and warns that failure to do so may result in acceleration of the debt. If the owner fails to remedy the default, subject to any necessary HUD approval, the lender/servicer may notify the owner in writing that its debt is accelerated and demand that the owner pay the debt in full by a stated due date.

2) A covenant default also occurs when there is a violation of a provision of the regulatory agreement. Under these circumstances, HUD has discretion to pursue any of the remedies specified in the regulatory agreement. HUD's regional center/satellite office director can issue a notice of violation (NOV) of the regulatory agreement letter to the project owner, setting forth the nature of the violation, the intended action the owner must take to cure the violation, a cure period, and the consequences of failing to cure the violation, including citations to the relevant provision(s) of the regulatory agreement. If the owner does not cure the violation within the cure period, the regional center/satellite office director determines whether or not to declare a default under the regulatory agreement. Since the regulatory agreement is incorporated into

the mortgage and the regulatory agreement violation was not timely cured, the issuance of the NOD under the regulatory agreement will also constitute a covenant default under the mortgage. If the decision is to declare the owner in default under the regulatory agreement based upon failure to cure the violation, the regional center/satellite office director will concurrently prepare a NOD letter to the owner and a letter to the lender/servicer (for signature by the Director of the Office of Asset Management and Portfolio Oversight in HQ) requesting or instructing it to accelerate the outstanding principal indebtedness based on an uncured violation(s) under the regulatory agreement, in order to protect the interests of HUD (specific guidance is provided in 24 CFR 207.255, the regulatory agreement and loan documents). In response, the lender/servicer will accelerate the debt and notify the owner in writing that its debt is accelerated and that the accelerated amount must be remitted and the violation of the regulatory agreement must be cured within a 30-day time period. If the owner does not timely remit payment in full pursuant to the acceleration letter, a mortgage insurance claim will result based upon acceleration of the debt, as discussed below. Thus, issuing a NOD for violation of the regulatory agreement does not assure that the owner will cure the violation, but may position the lender to receive mortgage insurance benefits.

3) If the owner does not pay the accelerated debt in full as demanded, the default is treated as a covenant default for purposes of the regulations at 24 CFR 207.255, 207.256, and 207.257. However, for purposes of the lender’s eligibility for mortgage insurance benefits pursuant to 24 CFR 207.258, failure to pay the accelerated debt within the timeframe provided is treated as a fiscal default. In either case, if the owner fails to pay the indebtedness in full by the due date within the acceleration letter, the date of default is the day after the stated due date. If the acceleration letter does not state a specific due date, but contains language to the effect that the outstanding balance of principal and interest on the loan is declared immediately due and payable, the date of default is the day after the date of the acceleration letter. Note: A specific due date should be stated within the acceleration letter to avoid ambiguity.

4) The regulations at 24 CFR 207.256(a) require the lender/servicer to notify HUD of its intention to file a mortgage insurance claim within 30 days after the date of default.

8.1.4 Multifamily Delinquency and Default Reporting (MDDR) System

The MDDR system is a web-based system developed and implemented for servicing lenders of FHA-insured loans to report delinquencies, defaults, elections to assign, notices of assignments, reinstatements, withdrawals of assignment elections, and other loan-related information to HUD electronically. HUD’s regulations at 24 CFR Part 200, Subpart B, require a lender/servicer’s electronic filing of such notifications to HUD.

MDDR collects, tracks, and reports on lender/servicer' notifications and allows for management oversight by HUD. In addition, MDDR generates reports based upon a predefined set of criteria for all submission types. MDDR replaced form HUD-92426, Multifamily Default Status Report, and has been in use since 1999. All lenders/servicers servicing FHA-insured loans are required to register to use MDDR. Registration is through HUD's Single Family FHA Connection at the following link: https://entp.hud.gov/clas/index.cfm.

A. Reporting Fiscal Delinquencies/Defaults

1) Fiscal Delinquencies: The lender/servicer must notify HUD through MDDR of a delinquency when a payment is not received by the date when late fees are due, as set forth in the note and mortgage. Lenders/servicers generally report delinquencies within five days after a late fee can be imposed, but before the 30th day of the month.

2) Fiscal Defaults: If the payment is not made within 30 days after the due date, (the grace period), the lender is entitled to receive the benefits provided in its FHA contract of insurance in accordance with the applicable statute, regulations and instructions. The lender/servicer is required to notify HUD of such fiscal default through MDDR within 30 days after the final day of the grace period, or beginning on the 31st day after the payment was due. For example, if an owner defaults by failing to make payment on the loan on June 1, and no payment is made by July 1, the lender/servicer is required by regulation to submit the initial notice of fiscal default within 30 days thereafter, or by July 31. The date of default is the date of the first failure to make a monthly payment that subsequent payments by the owner are insufficient to cover when those subsequent payments are applied by the lender/servicer to the overdue monthly payments in the order in which they became due. The date of default is always the first day of the month.

3) Delinquency and default submissions in MDDR automatically generate an event/project action in the Integrated Real Estate Management System (iREMS) for the assigned regional center/satellite office account executive. When a delinquency or default occurs, the account executive sends a letter to the project owner notifying the owner of the delinquency or default, as applicable, and the potential consequences (Exhibits 8.1-1 and 8.1-2).

B. Reporting Covenant Defaults

1) Submissions in MDDR: The lender/servicer submits a covenant default in MDDR, which automatically puts the loan into a pending election to assign status to be approved/acknowledged by HUD (see Section 8.1.4.C.5 below).

(a) The date of default for a covenant default is the date of the first uncorrected violation of a covenant or obligation for which the lender/servicer has accelerated the debt. Thus, if the owner fails to pay the indebtedness in full by the due date within the acceleration letter, the date of default is the day after the stated due date. If the acceleration letter does not state a specific due date, but contains language to the effect that the outstanding balance of principal and interest on the loan is declared immediately due and payable, the date of default is the day after the date of the acceleration letter. Note: A specific due date should be stated within the acceleration letter to avoid ambiguity.

2) Submissions to regional center/satellite office: Other covenant defaults may occur which would not result in HUD instructing the lender to accelerate the debt (e.g., when insufficient funds are remitted to cover the monthly RfR deposit, or other reserves required by HUD). In these instances, the lender/servicer notifies the appropriate regional center/satellite office by email/letter of the owner's failure to remit such funds. As discussed in Section 8.1.3.B.2 above, HUD has discretion under the regulatory agreement to decide whether to issue a NOV, NOD, or request, or require acceleration of the debt as indicated in the regulations (see 24 CFR 207.255). HUD's decision not to take immediate action does not preclude HUD from taking action later or with respect to subsequent similar violations.

C. Mortgage Assignments

1) If a fiscal default continues for a period of 30 consecutive days, the lender/servicer is entitled to receive mortgage insurance benefits in accordance with HUD regulations and instructions. (see Section 207(g) of the National Housing Act, 12 U.S.C. 1713(g) and 24 CFR Part 207, Subpart B).

2) The lender/servicer must submit an election to assign the mortgage or convey title through MDDR within the timeframes provided in 24 CFR Part 207.258 of HUD's regulations in effect when the note was endorsed for insurance. This timeframe is typically by the 75th day from the date of default, unless an extension of the election to assign has been requested by the lender/servicer and approved by the regional center/satellite office.

3) Extensions on an election to assign are approved on a case-by-case basis pursuant to these guidelines:

   a) Extensions should only be granted when the regional center/satellite office determines there is a viable plan to resolve the underlying cause of the default, and to avoid a mortgage insurance claim.

   b) The lender/servicer must submit a request for an extension of the timeframe for an election to assign through MDDR and then a project action is generated in iREMS, which notifies the account executive in the regional center/satellite office.

   c) The regional center/satellite office director approves or denies the lender/servicer's request to extend the timeframe for filing of an election to assign or convey title.

d) The approval or denial of the extension is relayed to the lender/servicer in writing (by email) and should include the basis for the approval or denial. The email must be retained in the project file/laserfische in the appropriate regional center/satellite office.

e) Extensions are generally approved in 30-day increments (but MDDR has options of 60-day and 90-day extensions) and are approved beginning from the deadline date for making an election to assign (typically the 75th day from the date of default). Approval of the extension and timeframe must be documented in the project action field in iREMS by the account executive.

4) Deadlines for lenders/servicers to file a notice of fiscal default and an election to assign a mortgage, or convey title, are important, as any late filings will result in a curtailment of the interest on a mortgage insurance claim paid in cash when a mortgage is assigned or title conveyed. Interest is not curtailed when the lender/servicer elects to be paid in debentures, if permitted by the insuring statute.

5) OAMPO staff approve an election to assign or convey title in the MDDR system. For an election to assign, an automatic generated acknowledgement letter is sent to the lender/servicer by email outlining instructions for submitting the claim for mortgage insurance benefits. The lender/servicer is provided 30 days from the date of this acknowledgement letter to record the assignment of mortgage to the Secretary of HUD per 24 CFR 207.258(b)(1)(i). For a conveyance of title, a letter will be mailed to the lender by HQ OAMPO providing instructions for the conveyance.

6) The lender/servicer may request an extension on the timeframe for recordation of assignment of mortgage through MDDR. OAMPO responds to the lender/servicer's request by email with an approval or denial, with input from the Office of General Counsel (OGC) and the regional center/satellite office. **An extension may only be granted if a partial payment of claim is being considered**. If there is a plan in place that avoids the assignment and additional time is needed to close a transaction (i.e., loan modification), or if the delay in the recordation of assignment is caused by extenuating circumstances beyond the control of the lender/servicer, the owner must advance funds to keep the loan in a rolling default. NOTE: Rolling default means that the owner never has more than two unpaid payments and that no more than 75 calendar days have elapsed since the oldest missed first payment.

7) Once an election to assign is approved and the mortgage is assigned to the Secretary, the lender/servicer is required to submit: (a) an application for mortgage insurance benefits with corresponding fiscal documents to the Multifamily Claims Branch pursuant to the Fiscal Instructions for Filing for Multifamily Insurance Benefits; and (b) legal documents to OGC, Office of

Insured Housing, Multifamily Mortgage Division, pursuant to the Legal Instructions Concerning Applications for Full-Insurance Benefits-Assignment of Multifamily Mortgages to the Secretary (Note: the Fiscal and Legal Instructions can be found within the MDDR system).

8) After assignment of the mortgage, the regional center/satellite office account executive sends the owner written notice that their mortgage has been assigned to HUD (refer to Chapter 8.3, Servicing and Monitoring HUD-Held Mortgages including M2M Loans). HUD becomes the holder of the note and collects payments and services the loan. The regional center/satellite office account executive continues to service projects with HUD-held loans in accordance with the guidance in Chapter 8.3.

9) Regional center/satellite office account executives are required to flag ownership entities and all principals in the Active Partners Performance System (APPS) whenever there is a fiscal or covenant default, a mortgage is assigned to HUD, or the project is conveyed to HUD.

8.1.5 REINSTATEMENTS

A. Filing for Reinstatement

A lender/servicer must file a reinstatement of a defaulted loan in MDDR if a defaulted loan becomes current prior to the deadline (including as extended) by which the lender/servicer must file an election to assign. A loan is considered current if the owner has remitted all past due amounts, late fees, and amounts due for the month in which the reinstatement is made.

B. Late Charges

Late charges are normally ineffective in enforcing collections; if late charges are assessed, they help the lender/servicer recover the increased costs associated with servicing delinquent accounts. If late charges are assessed, they are generally collected from the owner separately, i.e., late charges are not deducted from regular loan payments, escrows, other impound accounts, RfR funds, or residual receipts accounts. However, if more than once during a calendar year the regularly scheduled monthly payment is received after the date when a late fee can be imposed pursuant to the loan documents, the lender/servicer may deduct late charges from the interest accruing to either the RfR fund or the residual receipts account without the written consent of HUD or the owner for the second and subsequent late monthly payments during the calendar year (refer to HUD Handbook 4350.4, Chapter 2).

8.1.6 MDDR WATCHLIST

1) HUD also asks lenders/servicers to classify their loans and rate them in the MDDR system on a servicer watchlist. This is a voluntary action, but it helps to facilitate the rating process between HUD and lenders/servicers. All

delinquent and defaulted loans are rated because they are required by regulation to be reported through MDDR. However, lenders/servicers are strongly encouraged to input ratings in MDDR for loans that are not in default.

2) MDDR also requires the lender/servicer to input actions they have taken or will take with respect to mitigating issues that resulted in the inclusion of the loan on the watchlist.

8.1.7 RECOGNITION OF POTENTIAL DEFAULTS/PREVENTING ASSIGNMENTS

A. Resources

Prompt and accurate identification of the causes of default or of impending default is imperative. HUD account executives should utilize all available resources to assist them in identifying possible and actual defaults. Resources may include, but are not limited to, the following:

1) Real Estate Assessment Center (REAC) inspection scores;

2) management and occupancy review (MOR) reports;

3) MDDR reports;

4) audited annual financial statements (AFS); and

5) monthly accounting reports.

B. Indicators of Default

Projects experiencing physical, financial, or management problems may indicate an impending default. Indicators that suggest a potential default may exist include, but are not limited to, the following:

1) high or increasing vacancy rate;

2) debt service coverage ratio (DSCR) below 1.0;

3) persistent physical problems of a serious nature (such as health and safety problems, security problems, deferred maintenance, etc.);

4) unauthorized distributions, as defined in HUD Handbook 4370.2, *Financial Operations and Accounting Procedures for Insured Multifamily Projects*, or unauthorized diversions of project assets;

5) annual or monthly expenses that exceed income potential and will more than likely continue;

6) project expenses are abnormally high or low compared to previous years or comparable projects;

7) abnormally low project rents;

8) project rents in excess of authorized limits;

9) bankruptcy has been declared or threatened by the owner/sponsor;

10) RfR funds have been requested more than once to pay for the loan payment, fuel, utilities, insurance, security or for routine expenses for which the account was never intended;

11) below satisfactory rating on MOR report or REAC score;

12) AFS disclose significant irregularities, such as qualified auditor's opinions, negative cash throw-offs, line items that are inconsistent with each other, the prior years', or with similar projects; under-funded reserves and escrow accounts; increasing account payables, receivables, or bad debts;

13) AFS are not submitted within 60 days after close of the project's fiscal year;

14) monthly accounting reports are not submitted to the regional center/satellite office in a timely manner, or are submitted sporadically;

15) Section 8 units that do not meet physical standards and project funds are not available to immediately correct the deficiencies;

16) owner has abandoned or has threatened to abandon the project; and/or

17) commercial space is not adequate to rent or is being rented at uneconomic rents, causing a cash drain on the project, or commercial space detracts from project livability.

C. Risk Rating Procedures

OAMPO established multifamily risk rating procedures for FHA-insured (as well as HUD-held) loans. Refer to Chapter 2.4, Risk Management, for further guidance on risk mitigation and how projects are continuously monitored and assets rated according to scale. Monthly calls are held between OAMPO and regional center/satellite offices to ensure consistency, follow up on troubled assets, and foster communication on the rating process.

Using the tools outlined in Sections 8.1.6 and 8.1.7.A-C of this chapter provides a mechanism for the regional center/satellite office account executive, owner, and lender/servicer to work together on early recognition of possible problems that may lead to default/assignment, and an opportunity to provide possible remedies to prevent or cure a default and avoid a mortgage insurance claim.

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0041 and 2502-0118. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Exhibit 8.1-1 Sample Letter to Owner for Fiscal Delinquency

DATE

Owner Name
Individual
Role in owner entity
Address
City, State, Zip

Dear _____________:

SUBJECT: FHA Project Name:
FHA Project Number:
Project location (city and state)

HUD has received a notice from your lender/servicer that the (monthly) loan payment for the subject project is delinquent. As you are aware, loan payments are due on the first of each month.

If the project is experiencing physical or financial problems that are affecting your ability to make timely mortgage payments, please advise this office. A meeting to discuss the project's ability to meet its financial obligations can be arranged with my office if it would be helpful.

Please contact______________________ of my staff at ___________________ to arrange a meeting.

Please be advised that in the event your loan defaults and the mortgage is assigned to the Secretary, HUD would implement procedures that may have a financially undesirable effect on you. These actions may include, but are not limited to, pursuing foreclosure or sale of the note. In addition, the owner entity and all principals will be flagged in HUD's Active Partners Performance System (APPS) for the default, assignment, and subsequent disposal action. An assignment of the mortgage will also affect your Previous Participation (form HUD-2530) certification since you are required to report all defaults on form HUD-2530, whenever that form is required to be submitted.

In order to comply with your obligations under the mortgage and note, and to avoid these potentially undesirable actions, you are required to cure the delinquency immediately and make your monthly payments timely in the future.

Sincerely,

Director,
Regional Center/Satellite Office

Exhibit 8.1-2 Sample Letter to Owner for a Fiscal Default

DATE

Owner Name
Individual
Role in owner entity
Address
City, State, Zip

Dear _____________:

SUBJECT: FHA Project Name:
FHA Project Number:
Project location (city and state)

HUD has received a notice from your lender/servicer that the loan on the subject project is in default. **You must cure this default immediately.**

Please be advised that in the event your mortgage is assigned to the Secretary, HUD would implement procedures that may have a financially undesirable effect on you. These actions may include, but are not limited to, pursuing foreclosure or sale of the note. In addition, the owner entity and all principals will be flagged in HUD's Active Partners Performance System (APPS) for the default, assignment, and subsequent disposal action. An assignment of the mortgage will also affect your Previous Participation (form HUD 2530) certification since you are required to report all defaults on form HUD 2530 whenever that form is required for submission.

HUD is very serious about preventing the assignment of insured mortgages. If the project is experiencing physical or financial problems that are affecting your ability to make timely loan payments, please advise this office within _____days of this letter. A meeting to discuss the project's ability to meet its financial obligations and discuss possible remedies to cure the default can be arranged with my office if it would be helpful. If your lender/servicer assigns this mortgage, HUD will require you to cure the default immediately or disposition actions will commence.

If you have any questions, please contact ____________, Account Executive, at (telephone number).

Sincerely,

Director,
Regional Center/Satellite Office