

**DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT****24 CFR Parts 27 and 290**

[Docket No. FR-4583-F-02]

RIN 2501-AC69

**Prohibited Purchasers in Foreclosure Sales of Multifamily Projects With HUD-Held Mortgages and Sales of Multifamily HUD-Owned Projects**

AGENCY: Office of the Secretary, HUD.

ACTION: Final rule.

**SUMMARY:** This final rule prohibits a mortgagor or any related party from bidding on or acquiring a multifamily property that was, itself, the subject of the mortgagor's default. The purpose of this rule is to prevent the mortgagor from benefiting from its default and failure to meet obligations under the term of its loan agreement. This rule follows a July 5, 2000 proposed rule and takes into consideration the public comments received on the proposed rule. After careful consideration of all the public comments received on the July 5, 2000 proposed rule, HUD has decided to adopt the proposed rule without change.

**DATES:** *Effective Date:* August 8, 2001.**FOR FURTHER INFORMATION CONTACT:**

Marc Harris, Director, Field Asset Management Division, Office of Asset Management, Department of Housing and Urban Development, Room 6164, 451 Seventh Street SW, Washington, DC 20410, telephone (202) 708-2654. Hearing or speech-impaired individuals may call 1-800-877-8339 (Federal Information Relay Service TTY). (Other than the "800" number, these are not toll-free numbers.)

**SUPPLEMENTARY INFORMATION:****I. The July 5, 2000 Proposed Rule**

On July 5, 2000 (65 FR 41538) HUD published for comment a proposed rule amending HUD's regulations contained at 24 CFR parts 27 and 290 governing disposition procedures applicable to (1) the foreclosure of multifamily properties subject to a HUD-held mortgage and (2) the sale of HUD-owned multifamily properties. The rule codifies current HUD policy by adding a new paragraph (f) to § 27.20 and a new § 290.18, respectively, to prohibit the defaulting mortgagor or a related party as defined at 24 CFR 24.105 from bidding on or acquiring the property that secured the defaulted mortgage.

The rule supports HUD's asset management responsibilities by preventing the defaulting party from benefiting from the re-purchase of a

multifamily property that was either foreclosed or sold directly from HUD's real estate inventory. For example, there have been occasions where mortgagors intentionally allowed a property to go into foreclosure and subsequently re-purchased the property for less than the debt amount or at more lenient terms than contained in the original mortgage. Permitting a current or prior mortgagor who is or was in such serious default as to lead to foreclosure or HUD acquisition to make an "end-run" around its loan agreement is antithetical to HUD's objective of promoting efficient and equitable administration of housing resources. Furthermore, it permits borrowers that are unwilling to comply with mortgage requirements, including permissible loan modifications, to reap an unfair benefit at the expense of the public. The rule does, however, preserve the authority of the Assistant Secretary for Housing—Federal Housing Commissioner to waive bidding or purchase restrictions in cases where HUD's best interest is served by permitting the defaulting mortgagor or a related party to acquire the property.

**II. Public Comments Generally**

The public comment period for the proposed rule closed on September 5, 2000. HUD received three comments in response to the proposed rule. Two were from law firms representing multifamily housing groups and one was from an association of multifamily rental developers and operators.

All three commenters opposed the rule. The objections centered on the prohibitive tenor of the rule and its corresponding limitation on the ability of any defaulting mortgagor to participate in the disposition process.

**III. This Final Rule**

The following section of the preamble contains a summary of the significant issues raised by the public commenters and HUD's response to their comments. For the reasons noted below, HUD has decided to adopt the proposed rule without change.

**IV. Discussion of Public Comments Received on the July 5, 2000 Proposed Rule**

*Comment:* The rule unfairly limits the opportunity of a mortgagor to participate in the disposition process and, in doing so, deprives HUD of the benefit of increased competition. (#1,2,3)

*HUD's Response:* HUD agrees that the rule severely limits the opportunity of a defaulting mortgagor to participate in the disposition process. The rule is not, however, unfair. The underlying

purpose of the rule is to prevent the mortgagor from benefiting from its default and failure to meet obligations under the term of its loan agreement with HUD. While this limitation may decrease competition by one, it supports HUD's asset management responsibilities by preventing a defaulting mortgagor from deriving an unfair benefit at the public expenses. HUD has therefore determined that prohibiting the mortgagor from bidding is more important than the minimal loss of competition that may result.

*Comment:* The rule makes a presumption of guilt, and by precluding participation by all defaulting mortgagors, eliminates the benefit of bidding by parties with specific project knowledge and the motivation to submit a fair offer. (#1,2)

*HUD's Response:* The purpose of the rule is to prevent the mortgagor from benefiting from its default and failure to meet obligations under the term of its loan agreement by purchasing the property at a foreclosure sale or from the HUD-owned inventory for less than the outstanding debt. The defaulting mortgagor can always pay off the outstanding debt in full prior to the foreclosure sale.

The failure of a project to meet its commitments to HUD is, in most cases, directly related to the mortgagor's failure to comply with one or more aspects of the agreements between HUD and the mortgagor/former mortgagor. In the rare event that the mortgagor can show that it should not be prohibited from bidding less than the debt, a waiver of this regulation by the Assistant Secretary for Housing—Federal Housing Commissioner, is permitted.

*Comment:* The rule should establish a detailed process for obtaining a waiver in cases where the mortgagor was not at fault. (#2)

*HUD's Response:* HUD will follow its usual process and consider a waiver request of this regulatory requirement for good cause shown on a case-by-case basis.

*Comment:* The rule should be redrafted in order to presume the eligibility of all parties to bid and allow the Assistant Secretary for Housing—Federal Housing Commissioner to exclude by waiver only upon a showing of sufficient cause. (#2)

*HUD's Response:* A waiver to the rule is contemplated only in narrowly-drawn circumstances where the defaulting mortgagor has demonstrated good cause to HUD's that it should be allowed the opportunity to participate in the disposition process. Thus, the burden rests with the defaulting mortgagor to

present the necessary level of justification for a waiver. Presuming the eligibility of all defaulting mortgagors to bid would be contrary to Departmental policy and would defeat the essential purpose of the rule.

*Comment:* The rule may deprive mortgagors of a constitutional property interest by denying their opportunity to bid and thus making them subject to a lower sales price that will diminish their equity. (#3)

*HUD's Response:* The rule does not deprive mortgagors of a constitutional property interest. A mortgagor is obligated for the amount of the debt and can pay off the outstanding debt prior to a foreclosure sale. The rule simply prevents a defaulting mortgagor from deriving an unfair benefit by acquiring the underlying property for less than the debt amount or with less restrictive loan conditions.

*Comment:* The rule is unnecessary because HUD has other, more effective remedies such as making a credit bid at foreclosure or appointing a receiver. (#3)

*HUD's response:* HUD has determined that this rule is needed for the reasons specified above. In addition, HUD generally seeks to be outbid at foreclosure sales because HUD minimizes its costs by selling projects at foreclosure sales rather than bidding the debt, taking properties into inventory, and then selling them from the owned inventory. Bidding the debt is not a cost effective remedy for HUD. Also, appointing a receiver has nothing to do with limiting what a mortgagor can bid at a foreclosure sale, and thus is not a remedy.

## V. Findings and Certifications

### *Regulatory Flexibility Act*

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed and approved this rule, and in so doing certifies that this rule will not have a significant economic impact on a substantial number of small entities. This rule only addresses circumstances in which a party may benefit at the public expense by defaulting on its obligations, and does not impose any additional costs or burdens.

### *Environmental Impact*

A Finding of No Significant Impact with respect to the environment was made at the proposed rule stage in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969. That Finding remains applicable to this rule and is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of the General Counsel, Regulations Division, Department of Housing and Urban Development, Room 10276, 451 Seventh Street SW., Washington, DC 20410.

### *Federalism Impact*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on State and local governments and is not required by statute, or the rule preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive Order. This final rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

### *Unfunded Mandates*

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1532) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. This final rule does not impose a Federal mandate that will result in the expenditure by State, local, or tribal governments in the aggregate, or by the private sector, of \$100 million or more in any one year.

### **List of Subjects**

#### *24 CFR Part 27*

Administrative practice and procedure, Loan programs—housing and community development, Mortgages.

#### *24 CFR Part 290*

Loan programs—housing and community development, Low and

moderate income housing, Mortgage insurance.

Accordingly, parts 27 and 290 of title 24 of the Code of Federal Regulations are amended as follows:

### **PART 27—NONJUDICIAL FORECLOSURE OF MULTIFAMILY AND SINGLE FAMILY MORTGAGES**

1. The authority citation for 24 CFR part 27 continues to read as follows:

**Authority:** 12 U.S.C. 1715b, 3701–3717; 3751–3768; 42 U.S.C. 1452b, 3535(d).

2. In § 27.20, a new paragraph (f) is added to read as follows:

#### **§ 27.20 Conditions of foreclosure sale.**

\* \* \* \* \*

(f) The defaulting mortgagor, or any principal, successor, affiliate, or assignee thereof, on the multifamily mortgage being foreclosed, shall not be eligible to bid on, or otherwise acquire, the property being foreclosed by the Department under this subpart or any other provision of law. A "principal" and an "affiliate" are defined as provided at 24 CFR 24.105.

### **PART 290—DISPOSITION OF MULTIFAMILY PROJECTS AND SALE OF HUD-HELD MULTIFAMILY MORTGAGES**

3. The authority citation for 24 CFR part 290 continues to read as follows:

**Authority:** 12 U.S.C. 1701z–11, 1701z–12, 1713, 1715b, 1715z–1b, 1715z–11a; 42 U.S.C. 3535(d) and 3535(i).

4. In subpart A, a new § 290.18 is added, to read as follows:

#### **§ 290.18 Restrictions on sale to former mortgagors.**

The defaulting mortgagor, or any principal, successor, affiliate, or assignee thereof, on the mortgage on the property at the time of the default resulting in acquisition of the property by HUD shall not be eligible to purchase the property. A "principal" and an "affiliate" are defined as provided at 24 CFR 24.105.

Dated: June 28, 2001.

**Mel Martinez,**

*Secretary.*

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