

## DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

### 24 CFR Parts 200 and 401

[Docket No. FR-4751-P-01; HUD 2006-0003]

RIN 2502-AH86

### Implementation of Mark-to-Market Program Revisions

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Proposed rule.

**SUMMARY:** Based on statutory changes and HUD's technical operational experience in administering the program, this proposed rule would implement a number of changes to the Mark-to-Market (M2M) program, HUD's mortgage restructuring program for FHA-insured projects with project-based Section 8 assistance, to facilitate processing. Unlike the M2M proposed and final rules addressing renewal of expiring Section 8 project-based assistance contracts that HUD published on January 12, 2006, this rule addresses a range of administrative and programmatic issues other than the project-based assistance contracts.

**DATES:** *Comment Due Date:* May 15, 2006.

**ADDRESSES:** Interested persons are invited to submit comments regarding this rule to the Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410-0500. Interested persons also may submit comments electronically through the Federal eRulemaking Portal at: <http://www.regulations.gov>. Commenters should follow the instructions provided on that site to submit comments electronically. Facsimile (FAX) comments are not acceptable. In all cases, communications must refer to the docket number and title. All comments and communications submitted will be available, without change, for public inspection and copying between 8 a.m. and 5 p.m. weekdays at the above address. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the public comments by calling the Regulations Division at (202) 708-3055 (this is not a toll-free number). Copies are also available for inspection and downloading at <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:** Theodore Toon, Acting Deputy

Assistant Secretary, Office of Affordable Housing Preservation (OAHP), Department of Housing and Urban Development, 451 Seventh Street, SW., Room 6230, Washington, DC 20024, (202) 708-0001 (this is not a toll-free number). Persons with hearing or speech impairments may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877-8389.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

The Multifamily Assisted Housing Reform and Affordability Act (MAHRA) became law on October 27, 1997. (See Pub. L. 105-65, 111 Stat. 1384, 42 U.S.C. 1437f note.) The Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act for Fiscal Year 1999 (Pub. L. 105-276, approved October 21, 1998) revised section 524(a)(2) of MAHRA to make renewal of expiring contracts under that section subject to section 516 of MAHRA, which prohibits mortgage restructuring and consideration of requests for contract renewals in the case of certain kinds of conduct by the project owner. On October 20, 1999, the Departments of Veterans Affairs, Housing and Urban Development, and Independent Agencies Appropriations Act for Fiscal Year 2000, Public Law 106-74, 113 Stat. 1047, at 1110, extensively revised section 524 of MAHRA. Among other changes, the revisions changed the method for calculating rents when an expiring or terminating Section 8 contract is renewed, and required reduction to comparable market rents for certain projects that, prior to expiration or termination, had rents that exceeded such comparable market rents.

The Mark-to-Market Extension Act of 2001 (Title VI of Pub. L. 107-116, approved January 10, 2002) (Mark-to-Market Extension Act) amended sections 512, 514, 517, and 524 of MAHRA and section 223(a)(7) of the National Housing Act (12 U.S.C. 1715n). Part II of this preamble discusses the proposed implementation of those amendments and additional proposed revisions to HUD's mortgage restructuring program in this notice of proposed rulemaking (NPRM).

MAHRA is currently implemented in HUD's regulations at 24 CFR parts 401 and 402. These regulations were initially published as an interim rule on September 11, 1998 (63 FR 48926). On March 22, 2000, HUD published a final rule implementing 24 CFR part 401 and portions of 24 CFR part 402 (65 FR 15485).

In order to facilitate restructurings under MAHRA, this rule also amends HUD's regulations at part 200. Part 200 is the introductory section addressing HUD's mortgage insurance programs under the National Housing Act, 12 U.S.C. 1701 *et seq.* The specific sections being amended are 24 CFR 200.20, which applies to the refinancing of insured mortgages, and 24 CFR 200.40, which sets HUD's fees and charges for its mortgage insurance programs.

##### II. This Notice of Proposed Rulemaking (NPRM)

###### A. Section 200.20 *Refinancing Insured Mortgages*

Section 615 of the Mark-to-Market Extension Act amended section 223(a)(7) of the National Housing Act (NHA) to permit refinancing mortgages under that section for existing mortgages subject to restructuring under MAHRA. This NPRM proposes a revision to 24 CFR 200.20 to implement this provision. The term of such mortgages would be limited to 30 years, and the mortgages would have to meet the legal requirements of section 223(a)(7) of the NHA and pertinent regulatory requirements established by HUD.

###### B. Section 200.40 *HUD Fees*

HUD, in its regulations implementing its insured mortgage programs under the NHA, typically charges various transactional fees that HUD is authorized, but not required, to collect. In its experience, HUD has found that these fees have discouraged participation in the Mark-to-Market program. This NPRM proposes to revise § 200.40(h) by exempting transfer fees where the transfer of physical assets or substitution of mortgagors is in connection with a restructuring plan under HUD's regulations implementing MAHRA. This NPRM also proposes to revise 200.40(j) to state that an application or commitment fee shall not be required in connection with the insurance of a mortgage used to facilitate a restructuring plan under HUD's MAHRA regulations.

###### C. Section 401.2 *What Special Definitions Apply to This Part?*

This rule makes a conforming change to the definition of "Office of Multifamily Housing Assistance Restructuring" (OMHAR) at § 401.2 to include the Office of Affordable Housing Preservation (OAHP) or any successor office. This change will obviate the need for extensive conforming revisions to part 401 in the event of subsequent administrative changes at HUD.

*D. Section 401.101 Which Owners Are Ineligible To Request Restructuring Plans?*

Section 612(c) of the Mark-to-Market Extension Act amended section 516(d) of MAHRA by requiring the Office of Multifamily Housing Restructuring to notify tenants if a mortgage restructuring plan was rejected, and made this duty delegable to the participating administrative entity (PAE). At 24 CFR 401.500(f)(2), HUD currently requires the PAE to make the notification. This NPRM proposes to amend § 401.500(f)(2) to require HUD or the PAE to provide the necessary notice. Also under this NPRM, 24 CFR 401.101(d) would be amended to reflect this requirement, for consistency and clarity.

*E. Section 401.304 Portfolio Restructuring Agreement (PRA) Provisions on PAE Compensation*

As additional properties come into the mortgage restructuring program, HUD determines whether existing PAEs are willing and able to add those properties to their portfolios. This process allows HUD to determine whether existing PAE compensation, including base fees and incentives, is adequate. HUD's experience shows that it can adjust PAE's compensation accurately through this process, and that the requirement in the current rule for an annual market survey is unnecessary. Therefore, in the interests of regulatory simplification, this NPRM proposes to remove the market survey requirement from 24 CFR 401.304(a)(2). The proposed amendment to 24 CFR 401.304(b) would clarify that all PAEs potentially have the opportunity to earn the same amount of incentives per completed transaction.

*F. Section 401.309 PRA Term and Termination Provisions; Other Provisions*

HUD has from time to time negotiated with PAEs for the removal of assets from PRAs, in exchange for partial base fees and reimbursement of amounts incurred by the PAE for third-party vendors. This NPRM proposes to amend 24 CFR 401.309(b)(2) to give HUD regulatory authority to require removal of assets in PRAs. This NPRM also proposes to amend § 401.309(c) to clarify HUD's ability to recover damages from a PAE during the term of the PRA.

*G. Section 401.401 Consolidated Restructuring Plans*

This NPRM proposes to add a new sentence to the end of 24 CFR 401.401 stating that HUD's decision whether to approve a consolidated restructuring

plan will be made on a case-by-case basis.

*H. Section 401.452 Property Standards for Rehabilitation*

Section 612(e) of the Mark-to-Market Extension Act added a new section 517(c)(2) to MAHRA authorizing a restructuring plan to require the addition to a project of "significant features," such as an elevator, air conditioning, and community space, which are not required for rehabilitation of the project to a non-luxury standard adequate to the rental market in which the project is located, and specifying the funding and amount of owner contribution for such features. The NPRM proposes revising 24 CFR 401.452 to state that rehabilitation under the restructuring plan may include the addition of significant features, and to refer to 24 CFR 401.472, which would contain further requirements regarding significant features.

*I. Section 401.461 HUD-Held Second Mortgage*

Section 612(g)(1) of the Mark-to-Market Extension Act amended section 517(a)(1)(B) of MAHRA to provide that a restructuring plan shall include a second mortgage in an amount not more than the greater of the full or partial payment of claim or the difference between the restructured first mortgage and the original indebtedness prior to restructuring. In addition, an overall cap was imposed that limits the second mortgage to an amount that HUD or the PAE determines can reasonably be expected to be repaid. The change made by section 612(g)(1) of the Mark-to-Market Extension Act is proposed to be implemented in 24 CFR 401.461(a)(2)(ii).

The second, and any additional, mortgage to HUD secures repayment of HUD funds used in a restructuring transaction. HUD funds are available from either the section 541(b) full or partial payment of claim, or from residual receipts accumulated pursuant to the expiring housing assistance payments (HAP) contract subject to the regulatory provisions in 24 CFR 880.205(e), 881.205(e), and 883.306(e).

Section 517(b)(6) of MAHRA provides for the use of surplus project accounts to facilitate restructuring under MAHRA. Surplus project accounts are available when the combination of a pre-restructuring reserve for replacement account and residual receipt account balances are greater than the initial deposit to the reserve for replacement required after restructuring. MAHRA provides that up to 10 percent

of such surplus may be released to the owner (see section 517(b)(6) of MAHRA). The remaining surplus funds are to be used for other purposes, including facilitating the debt restructuring transaction. Generally, for restructuring of FHA-insured mortgages, the surplus funds are used to reduce the amount of the partial payment of claim. For the restructuring of HUD-held mortgages, there would be no need for a partial payment of claim; in such a case, the typical use is to increase the net cash proceeds of the restructuring and thus reduce the "write-down." This NPRM proposes amending 24 CFR 401.461(a)(1) to include, among the situations where a full payment of claim is not needed, those cases where section 517(b)(6) surplus accounts are available to facilitate the restructuring.

To the extent the source of the surplus project accounts is existing reserve for replacement funds, or residual receipts not subject to 24 CFR 880.205(e), 881.205(e), and 883.306(e) (which allow HUD to place such funds into an account to be used for reduction of housing assistance payments or other project purposes), HUD's restructuring plan would not take back an additional mortgage. For the restructuring of HUD-held mortgages, the surplus funds increase the net cash proceeds of the restructuring to provide partial repayment of the previously paid FHA claim. To the extent the residual receipts are subject to 24 CFR 880.205(e), 881.205(e), and 883.306(e) (which allow surplus project funds to be used for reducing housing assistance payments or other project purposes), the surplus funds will be treated as HUD funds and will be reflected in an increased second mortgage amount (or third mortgage, as applicable). However, where the reduction in principal amount of the restructured HUD-held mortgage is not caused by a source of new mortgage funds or amounts subject to 24 CFR 880.205(e), 881.205(e), or 883.306(e) the proposed amendment to 24 CFR 401.461(c) provides that the restructuring plan may require the owner to give an additional mortgage to HUD in the amount of the difference between the reduced principal amount of the restructured mortgage and the principal amount of the second mortgage.

HUD is also proposing in this rule to remove the prohibition against compound interest on second and third HUD-held mortgages. The existing regulations (§ 401.461(b)(1)) require that the interest rate on the second mortgage created in the M2M debt restructuring must have an interest rate of at least 1 percent but not more than the

Applicable Federal Rate (AFR). The regulations further require that the interest rate "will accrue but not compound." The intent of this requirement was to minimize the debt burden created by accruals on the unpaid balance of the M2M second mortgage. The additional mortgage (third mortgage) described in § 401.461(c) requires the same terms and conditions as the second mortgage.

The number of debt restructurings being financed with equity raised under the Low Income Housing Tax Credit (LIHTC) program is increasing. A portion of these tax credit restructurings involve what is referred to in the industry as "9 percent credits," which generate far more equity for the redevelopment of the project than the more readily available "4 percent credits." HUD has been informed by tax counsel to a number of tax credit purchasers that the Internal Revenue Service (IRS) will not allow the M2M subordinate debt to be used as "basis" in a "9 percent credit" transaction if the debt is set at less than the AFR and if the interest does not compound. The M2M rate of 1 percent at simple interest is considered by IRS to be "subsidized debt" and, as a result, the 9 percent credits are reduced to 4 percent credits.

The existing regulations allow the interest rate to be set at the AFR, but HUD has had to issue regulatory waivers on a number of these transactions to allow the rate to compound. The waivers have clearly served the best interests of both HUD and the project. This regulatory change removes the reference to simple interest and thereby allows HUD to use its administrative discretion in requiring simple or compounding interest. Simple interest will remain the program standard, but compounding will be allowed where it serves the best interest of the government and the individual debt restructuring. The regulations governing the third mortgage would also be amended to conform to the language governing the second mortgage.

This NPRM proposes to revise 24 CFR 401.461(b)(5) to implement section 612(g)(2) of the Mark-to-Market Extension Act. Section 612(g)(2) amended section 517(a)(5) of MAHRA to provide that, in addition to modifying or forgiving all or part of the second mortgage, HUD may assign the second mortgage to a purchaser that is a tenant organization or tenant-endorsed community-based nonprofit or public agency. Such a purchaser is currently defined at § 401.2 as a priority purchaser. This rule would also add a new § 401.480(e), as discussed below in this preamble, to provide a procedure

for a community-based non-profit or public agency that is a purchaser to obtain tenant endorsement in order to qualify as a priority purchaser.

This rule would also revise § 401.461(c), which addresses additional mortgages to HUD, to provide that if HUD modifies, assigns, or forgives a second mortgage in accordance with § 401.461(e) pursuant to section 517(a)(5) of MAHRA, that it may modify, assign, or forgive the additional mortgage (third mortgage or contingent repayment mortgage) that is part of the same restructuring. Specifically, § 401.461(c) would provide that, as part of a restructuring, HUD may elect either to not create an additional mortgage or to create an additional mortgage in an amount less than required if the anticipated recovery on the additional mortgage is less than the servicing costs; or if the restructuring plan approved the modification, forgiveness, or assignment of a second mortgage (Mortgage Repayment Mortgage) created under § 401.461(b)(5) pursuant to section 517(a)(5) of MAHRA.

*Example of second mortgages in a restructuring transaction.* Assume an FHA-insured property subject to a Restructuring Plan has a pre-restructuring first mortgage of \$2 million, and can support \$900,000 of first-mortgage debt after restructuring. After the required owner contributions, additional funding of \$270,000 is needed for the repair escrow, for the initial deposit to the reserve for replacement, and for transaction costs. If no surplus project account funding is available, the section 541(b) partial payment of claim would be increased by \$270,000 (i.e., from \$1.1 million to \$1.37 million) to make available some of the proceeds from the new first mortgage to fund the repair escrow, initial deposit to the reserve for replacement, and transaction costs. In this case, the second mortgage would be limited by the lesser of: (1) The amount reasonably repayable; or (2) \$1.37 million. The potential third mortgage amount would be up to the difference, if any, between \$1.37 million and the second mortgage.

If surplus project accounts of \$400,000 from other than residual receipts pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e), and after 10 percent of the surplus was released to the owner, were available, the partial payment of claim required and the maximum second mortgage would be reduced accordingly to \$970,000. If the source of the surplus project accounts were residual receipts accumulated pursuant to 24 CFR 880.205(e), 881.205(e), or 883.306(e), HUD would

take back a second mortgage of \$1.37 million, assuming that amount could be reasonably expected to be repaid, reflecting the total HUD funds to be used in the restructuring (\$970,000 from the partial payment of claim and \$400,000 from the residual receipts).

If a HUD-held first mortgage is being restructured, there is no need for a partial payment of claim. Thus, the second mortgage is limited by section 517(a)(1)(B)(ii) of MAHRA to the difference in the first mortgage indebtedness before and after restructuring (\$1.1 million in the example). To the extent that the amount of the HUD-held debt is not refinanced through a new first or Mark-to-Market second mortgage, or repaid from the net cash proceeds of the restructuring, HUD would either take back a third mortgage pursuant to 24 CFR 401.461(c), or, if a third mortgage is not to be taken back, or is taken back in a lesser amount, HUD would originate the third mortgage at the closing, and then cancel or modify it accordingly.

OAHP has provided additional guidance in its Operating Procedures Guide (OPG) and through an underwriting model used by PAEs. The OPG and underwriting model are both available at OAHP's Web site, <http://www.hud.gov/offices/omhar>.

#### *J. Section 401.472 Rehabilitation Funding*

This proposed amendment to 24 CFR 401.472 implements section 612(e) of the Mark-to-Market Extension Act, which amended section 517 of MAHRA to provide for a cap on owner contributions with respect to the addition of significant features. For example, the addition of air conditioning (including conversions from window air conditioning to central air conditioning), an elevator, or additional common community space will be considered significant. Upgrades (for example, replacement of windows with more efficient windows) are not eligible for this capped owner contribution. If a restructuring plan includes additions other than those specified, and the PAE considers the additions significant, the PAE may propose to make those additions subject to the cap on owner contributions. In general, the owner will contribute 3 percent toward the cost of each significant addition. The PAE may propose a lower or higher owner contribution, not to exceed 20 percent, with respect to significant additions. The 20 percent ceiling, based on total cost, is the equivalent of the statutory 25 percent ceiling, based on the amount of assistance. For example, if the cost of an item were \$100,000, with the owner

contributing \$20,000 and assistance in the amount of \$80,000, the owner would contribute 20 percent of the total cost and 25 percent of the amount of assistance.

**K. Section 401.480 Sale or Transfer of Project**

Section 612(d) of the Mark-to-Market Extension Act amends section 524(e) of MAHRA to provide that properties with plans of action under the Emergency Low Income Housing Preservation Act of 1987 (12 U.S.C. 1715l note) or the Low-Income Housing Preservation and Resident Homeownership Act of 1990 (12 U.S.C. 4101 *et seq.*) are eligible for Mark-to-Market restructuring, but only if sold. This NPRM proposes to amend 24 CFR 401.480(b) to implement this provision. Sale is a condition of restructuring, and so HUD will require the sale to take place immediately, and under the original set of escrow instructions, if the sale has not occurred prior to the restructuring.

As noted above in the discussion of HUD-held second mortgages under § 401.461, this rule also proposes to add a new § 401.480(e) to establish the procedure for a community-based nonprofit organization or public agency purchaser to obtain tenant endorsement and qualify as a priority purchaser. A community-based nonprofit or public agency purchaser requesting tenant endorsement would be required to conduct two meetings, the first (the "Informational Meeting") to disseminate information about the endorsement request and the purchaser's plans for the project, and the second (the "Endorsement Vote") to conduct the voting for the endorsement. The purchaser would be required to provide notice of the Informational Meeting and Endorsement Vote to each tenant and any tenant organization for the project, and post notices of the two meetings in the project. If the purchaser is acting contemporaneously with the Restructuring Plan, the Informational Meeting would occur at the second meeting of tenants convened by the PAE pursuant to § 401.500(d) to discuss the restructuring plan.

The notices of the date and time for these meetings would be sent to each head of household in the project and would contain a ballot that includes a proxy authorizing a designated person to vote on behalf of such tenant household at the Endorsement Vote. The designated person may be the purchaser, the tenant organization, the PAE, or any individual that would attend the Endorsement Vote. In each notice, the purchaser would provide a narrative outlining its plans for the project, including any request made to HUD for debt relief under § 401.461(b)(5) of the second and any additional mortgage. The rule would permit the proxies to be collected from the tenants by the purchaser, from any tenant organization for the project, from the PAE, or from some other entity approved by HUD at any time, including at the Informational Meeting, up to the date and time of the Endorsement Vote.

The Endorsement Vote would be held at least 10 days after the Informational Meeting. Tenant households would cast their ballots and any remaining proxies would be gathered. The PAE then would determine whether the total of votes cast in person and by proxy equals a quorum of at least 10 percent of the total number of tenant households in the project. If there is such quorum, the votes would be tallied (including those cast by proxy), and a majority of the votes will determine whether or not the purchaser has the endorsement of the tenants. HUD specifically seeks comment on this proposed procedure to demonstrate tenant endorsement, and solicits recommendations for less prescriptive and more streamlined procedures that will meet the goal of providing an opportunity for the informed participation of tenants in a process that results in an endorsement that can reasonably be considered to be valid.

**L. Subpart F—Owner Dispute of Rejection and Administrative Appeal**

This rule would also revise the administrative appeals procedure in subpart F of part 401. Presently, § 401.645 provides an intermediate level appeal only for notices of rejection. This

rule would expand the availability of the intermediate level appeal to include a decision by HUD and the PAE to offer a proposed Restructuring Commitment that the owner does not execute. The reference to notices of rejection in § 401.645 would also be restated in more general terms to include any notice of rejection rather than listing specific sections under which a notice of rejection may be based. This change would eliminate the need for conforming changes if sections of the rule were to be revised and renumbered in the future, and would eliminate any confusion if a specific section that served as the basis for a notice of rejection were inadvertently omitted from the list. Besides addressing such procedural issues as providing for the appeals officer to be identified in HUD's notice to the owner, this rule would also establish the standard of review for appeals: for the intermediate level, the standard would be whether HUD's action is reasonable in light of all the evidence presented by the owner, and for the final level of administrative appeal, whether the determination of the appeals officer at the intermediate level was reasonably reached.

**III. Findings and Certifications**

**Paperwork Reduction Act**

The proposed information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) for review under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). Under this Act, an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a valid control number.

The public reporting burden for this collection of information is estimated to include the time for reviewing the instructions, searching existing data sources, gathering and maintaining the required data, and completing and reviewing the collection of information.

The following table provides information on the estimated public reporting burden:

Information collection § 401.480(e)	Number of respondents	Responses per respondent	Total annual responses	Hours per response	Total hours
Nonprofit Groups/Public Agencies .....	7	1	7	20	140
Tenants/Heads of Households .....	550	1	550	1	550
Totals .....	557	.....	557	.....	690

In accordance with 5 CFR 1320.8(d)(1), HUD is soliciting

comments from members of the public

and affected agencies concerning the proposed collection of information to:

(1) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

(3) Enhance the quality, utility, and clarity of the information to be collected; and

(4) Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated collection techniques or other forms of information technology, e.g., permitting responses to be submitted electronically.

Interested persons are invited to submit comments regarding the information collection requirements in this proposal. Under the provisions of 5 CFR 1320, OMB is required to make a decision concerning this collection of information between 30 and 60 days after today's publication date. Therefore, any comment on the information collection requirements is best assured of having its full effect if OMB receives the comment within 30 days of today's publication. This time frame does not affect the deadline for comments to the agency on the proposed rule, however. Comments must refer to the proposal by name and docket number (FR-4751-P-01) and must be sent to:

HUD Desk Officer, Office of Management and Budget, New Executive Office Building, Washington, DC 20503, FAX: (202) 395-6974, and  
Kathleen O. McDermott, Reports Liaison Officer, Office of the Assistant Secretary for Housing—Federal Housing Commissioner, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 9116, Washington, DC 20410-8000.

#### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531-1538) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments and the private sector. This rule, which implements a statutory mandate to establish a program for the resolution of a narrow category of disputes, will not impose any federal mandates on any state, local, or tribal government or the private sector within the meaning of the Unfunded Mandates Reform Act of 1995.

#### *Environmental Impact*

A Finding of No Significant Impact with respect to the environment was

made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332). The finding remains available for public inspection during regular business hours in the Office of the Rules Docket Clerk, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC 20410.

#### *Executive Order 12866*

The Office of Management and Budget (OMB) reviewed this rule under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this rule is a "significant regulatory action" (but not economically significant) as defined in section 3(f) of the Order. Any changes made in this rule subsequent to its submission to OMB are identified in the docket file. The docket file is available for public inspection between 8 a.m. and 5 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Room 10276, Washington, DC.

#### *Regulatory Flexibility Act*

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule does not have a significant economic impact on a substantial number of small entities.

This rule affects only multifamily Section 8 owners. There are very few multifamily Section 8 owners who are small businesses. Therefore, this rule will not have a significant economic impact on a substantial number of small entities.

Notwithstanding the determination that this rule does not have a significant impact on a substantial number of small entities, HUD specifically invites any comments regarding any less burdensome alternatives to this rule that will meet HUD's objectives as described in this preamble.

#### *Executive Order 13132, Federalism*

This 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 Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4; approved March 22, 1995) (UMRA) establishes requirements for federal

agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and the private sector. This rule does not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

#### **List of Subjects**

##### *24 CFR Part 200*

Administrative practice and procedure, Claims, Equal employment opportunity, Fair housing, Home improvement, Housing standards, Lead poisoning, Loan programs—housing and community development, Mortgage insurance, Organization and functions (Government agencies), Penalties, Reporting and recordkeeping requirements, Social security, Unemployment compensation, Wages.

##### *24 CFR Part 401*

Grant programs—housing and community development, Housing, Housing assistance payments, Housing standards, Insured loans, Loan programs—housing and community development, Low and moderate income housing, Mortgage insurance, Mortgages, Rent subsidies, Reporting and recordkeeping requirements.

Accordingly, HUD proposes to amend 24 CFR parts 200 and 401 as follows:

#### **PART 200—INTRODUCTION TO FHA PROGRAMS**

1. The authority citation for part 200 continues to read as follows:

**Authority:** 12 U.S.C. 1702-1715z-21; 42 U.S.C. 3535(d).

2. Revise § 200.20 to read as follows:

##### **§ 200.20 Refinancing insured mortgages.**

An existing mortgage insured under the Act, or an existing mortgage held by the Secretary that is subject to a mortgage restructuring and rental assistance sufficiency plan under the Multifamily Assisted Housing Reform and Affordability Act, 42 U.S.C. 1437f note (MAHRA), may be refinanced pursuant to section 223(a)(7) of the Act and such terms and conditions as may be established by the Commissioner. The term of such refinancing in connection with the implementation of an approved restructuring plan under section 401, subpart C of this title, may be up to, but not more than, 30 years.

3. In § 200.40, revise paragraphs (h) and (j) to read as follows.

##### **§ 200.40 HUD fees.**

\* \* \* \* \*

(h) *Transfer fee.* Upon application for the approval of a transfer of physical

assets or the substitution of mortgagors, a transfer fee of 50 cents per thousand dollars shall be paid on the original face amount of the mortgage in all cases, except that a transfer fee shall not be paid where both parties to the transfer transaction are qualified nonprofit purchasers, or when the transfer of physical assets or the substitution of mortgagors is in connection with a restructuring plan under part 401, subpart C of this title.

\* \* \* \* \*

(j) *Fees not required.* (1) The payment of an application, commitment, inspection, or reopening fee shall not be required in connection with the insurance of a mortgage involving the sale by the Secretary of any property acquired under any section or title of the Act.

(2) The payment of an application or commitment fee shall not be required in connection with the insurance of a mortgage used to facilitate a restructuring plan under part 401, subpart C of this title.

#### **PART 401—MULTIFAMILY HOUSING MORTGAGE AND HOUSING ASSISTANCE RESTRUCTURING PROGRAM (MARK-TO-MARKET)**

4. The authority citation for part 401 continues to read as follows:

**Authority:** 12 U.S.C. 1715z–1 and 1735f–19(b); 42 U.S.C. 1437(c)(8), 1437f(t), 1437f note, and 3535(d).

5. In § 401.2, revise the definition of OMHAR to read as follows:

#### **§ 401.2 What special definitions apply to this part?**

\* \* \* \* \*

OMHAR means the Office of Multifamily Housing Assistance Restructuring, the Office of Affordable Housing Preservation (OAHP), and any successor office.

\* \* \* \* \*

6. In § 401.101, add a new paragraph (d) to read as follows:

#### **§ 401.101 Which owners are ineligible to request restructuring plans?**

\* \* \* \* \*

(d) *Notice to tenants.* The PAE or HUD will give notice to tenants of a rejection in accordance with §§ 401.500(f)(2), 401.501, and 401.502.

7. In § 401.304, revise paragraphs (a)(2) and (b) to read as follows:

#### **§ 401.304 PRA provisions on PAE compensation.**

(a) \* \* \*

(2) HUD will establish a substantially uniform baseline for base fees for public entities. The base fee for a PAE will be

adjusted if necessary after the first term of the PRA.

\* \* \* \* \*

(b) *Incentives.* The PRA may provide for incentives to be paid by HUD. While individual components may vary between PAEs (both public and private), the total amount potentially payable under the incentive package will be uniform. Objectives may include maximizing savings to the Federal Government, timely performance, tenant satisfaction with the PAE's performance, the infusion of public funds from non-HUD sources, and other benchmarks that HUD considers appropriate.

\* \* \* \* \*

8. In § 401.309, revise the section heading and paragraphs (b)(2) and (c) to read as follows:

#### **§ 401.309 PRA term and termination provisions; other provisions.**

\* \* \* \* \*

(b) \* \* \*

(2) *Termination for convenience of Federal Government.* HUD may terminate a PRA, and may remove an eligible property from a PRA, at any time in accordance with the PRA or applicable law regardless of whether the PAE is in default of any of its obligations under the PRA if such termination is in the best interests of the Federal Government. The PRA will provide for payment to the PAE of a specified percentage of the base fee authorized by § 401.304(a) and amounts for reimbursement of third-party vendors to the PAE authorized by § 401.304(c).

\* \* \* \* \*

(c) *Liability for damages.* During the term of a PRA, and notwithstanding any termination of a PRA, HUD may seek its actual, direct, and consequential damages from any PAE for failure to comply with its obligations under PRA.

\* \* \* \* \*

9. Revise the section heading and add a new sentence to the end of § 401.401 to read as follows:

#### **§ 401.401 Consolidated Restructuring Plans.**

\* \* \* HUD's decision to approve or disapprove a Consolidated Restructuring Plan will be made on a case-by-case basis.

10. Revise § 401.452 to read as follows:

#### **§ 401.452 Property standards for rehabilitation.**

The restructuring plan must provide for the level of rehabilitation needed to restore the property to the non-luxury standard adequate for the rental market for which the project was originally

approved. If the standard has changed over time, the rehabilitation may include improvements to meet the current standards. The rehabilitation also may include the addition of significant features in accordance with § 401.472. The result of the rehabilitation should be a project that can attract non-subsidized tenants, but competes on rent rather than on amenities. When a range of options exists for satisfying the rehabilitation standard, the PAE must choose the least costly option considering both capital and operating costs and taking into account the marketability of the property and the remaining useful life of all building systems. Nothing in this part exempts rehabilitation from the requirements of part 8 of this title concerning accessibility to persons with disabilities.

11. In § 401.461, revise paragraphs (a)(1), (a)(2)(ii), (b)(1), (b)(5), and (c) to read as follows:

#### **§ 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 section 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) \* \* \*

(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 Restructuring 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 1 percent, but not more than the applicable federal rate.

\* \* \* \* \*

(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, 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, when it will be payable upon demand of HUD or as otherwise agreed by HUD.

12. Revise § 401.472(b) to read as follows:

**§ 401.472 Rehabilitation funding.**

\* \* \* \* \*

(b) *Statutory restrictions.* Any rehabilitation funded from the sources described in paragraph (a) of this section is subject to the requirements in section 517(c) of MAHRA for an owner contribution.

(1) *Addition of significant features.* With respect to significant added features, the required owner contribution will be as proposed by the PAE and approved by HUD, not to exceed 20 percent of the total cost. Significant added features include the addition of air conditioning (including conversions from window air conditioning to central air conditioning), an elevator, or additional community space.

(2) *Cap on owner contribution.* If a restructuring plan includes additions other than those specified, and the PAE considers the additions significant, the PAE may propose to make those additions subject to the cap on owner contribution. In general, the owner will contribute three percent toward the cost of each significant addition. The PAE may propose a lower or higher owner contribution, not to exceed 20 percent, with respect to significant additions.

(3) *Other rehabilitation.* With respect to other rehabilitation, the required owner contribution will be calculated as 20 percent of the total cost of rehabilitation, unless HUD or the PAE determines that a higher percentage is required. The owner contribution must include a reasonable proportion (as determined by HUD) of the total cost of rehabilitation from non-governmental resources.

(4) *Cooperatives.* The PAE may exempt housing cooperatives from the owner contribution requirement.

\* \* \* \* \*

13. In § 401.480 revise paragraph (b) and add paragraph (e) to read as follows:

**§ 401.480 Sale or transfer of project.**

\* \* \* \* \*

(b) *When must the restructuring plan include sale or transfer of the property?* If the owner is determined to be ineligible pursuant to § 401.101 or § 401.403, or if the property is subject to an approved plan of action under the Emergency Low Income Housing Preservation Act of 1987 or the Low Income Housing Preservation and

Resident Homeownership Act of 1990 as described in section 524(e)(3) of MAHRA, the Restructuring Plan must include a condition that the owner sell or transfer the property to a purchaser acceptable to HUD in accordance with paragraph (c) of this section. Such sale or transfer shall be a condition to the implementation of the Restructuring Plan.

\* \* \* \* \*

(e) *Tenant endorsement procedure for priority purchaser status.*

(1) *Required meetings.* A community-based nonprofit or public agency purchaser requesting tenant endorsement to obtain priority purchaser status must conduct two meetings:

(i) An Informational Meeting to disseminate information about both the endorsement request and the purchaser's plans for the project must be held with the tenants of the project. If the purchaser is acting contemporaneously with the Restructuring Plan, the Informational Meeting must occur at the second meeting of tenants convened by the PAE pursuant to § 401.500(d) to discuss the restructuring plan; and

(ii) An Endorsement Vote Meeting to conduct the voting for the endorsement must be held at least 10 days after the Informational Meeting.

(2) *Parties who must receive notice.* The purchaser must deliver notice of the Informational Meeting and the Endorsement Vote Meeting to each tenant household in the project and any tenant organization for the project, and post notices of the two meetings in the project.

(3) *Notice contents.* The notice must identify the place, dates, and times of the required meetings, include a brief description of the purpose of each meeting, and provide a narrative outlining the purchaser's plans for the project, including any request made to HUD for debt relief under § 401.461(b)(5) of the second and any additional mortgage. A notice delivered to a tenant household must also contain a ballot that includes a proxy authorizing a designated person to vote on behalf of such tenant household at the Endorsement Vote Meeting.

(4) *Tenant voting.* (i) Each tenant household in the project may cast one vote to either endorse or not endorse the purchaser.

(ii) A tenant household may cast its vote in person at the Endorsement Vote Meeting or by proxy.

(5) *Proxy vote.* (i) In lieu of casting its vote in person, a tenant household may use the proxy included in the meeting



notice to authorize a designated person to vote on its behalf. The designated person may be the purchaser, the tenant organization, the PAE, or an individual who will attend the Endorsement Vote Meeting.

(ii) Proxies to be cast at the Endorsement Vote Meeting may be collected from tenant households up to the date and time of the Endorsement Vote Meeting by the purchaser, the tenant organization, if any, for the project, the PAE, or any other entity approved by HUD at any time, including at the Informational Meeting.

(6) *Counting the vote.* At the Endorsement Vote Meeting, tenant households cast their ballots and any remaining proxies are gathered. The PAE then determines whether the total of votes cast in person or by proxy equals a quorum of at least 10 percent of the total number of tenant households in the project. If there is such quorum, the votes are tallied (including those cast by proxy), and a majority of the votes tallied determine whether or not the purchaser has the endorsement of the tenants.

14. Revise § 401.500(f)(2) to read as follows:

**§ 401.500 Required notices to third parties and meeting with third parties.**

\* \* \* \*

(f) \* \* \*

(2) Within 10 days after a determination that the Restructuring Plan will not move forward for any reason, HUD or the PAE shall provide notice to affected tenants that describes the reasons for the failure of the Plan to move forward and the availability of tenant-based assistance under § 401.602(c).

15. Revise § 401.645 to read as follows:

**§ 401.645 Owner request to review HUD decision.**

(a) *HUD notice of decision.* (1) HUD will provide notice to the owner of:

(i) A decision that the owner or project is not eligible for the Mark-to-Market program;

(ii) A decision not to offer a proposed Restructuring Commitment to the owner; and

(iii) A decision to offer a proposed Restructuring Commitment. The proposed Restructuring Commitment provided to the owner constitutes the notice of decision for purposes of requesting a review of a HUD decision.

(2) The notice of decision will include the reasons for the decision.

(3) The notice of decision will also notify the owner of the right to request a review of the decision or to cure any deficiencies on which the decision was based, the date by which the review request must be submitted or the deficiencies must be cured, which will be at least 30 days after the date of the notice of decision, and the address to which the review request is to be submitted.

(b) *Review request by owner.* (1) *Written statement.* The review request must specify in writing:

(i) Each item of the decision to which the owner objects;

(ii) The reasons for the owner's objections; and

(iii) All information in support of the objections that the owner wants HUD to consider.

(2) *Scope of information submitted.* HUD will not consider information first submitted to HUD in conjunction with an owner's request for review except for:

(i) Information that could not have been submitted previously; and

(ii) New health and safety information.

(c) *HUD review and final decision.* (1) HUD may expand the scope of review beyond the issues raised by the owner and may review and modify any term within the Restructuring Commitment without regard to whether the owner has raised an objection to that term, including adjustments to rents or expenses as underwritten by the PAE. If HUD does expand the scope of review, HUD will notify the owner of such action and provide an additional 30 days for the owner to raise any additional objections and provide additional information.

(2) Within 30 days of HUD's receipt of the owner's review request and any additional objections and information, HUD will review the request and, using a standard of what is reasonable in light of all of the evidence presented, issue a final decision. The final decision will:

(i) Affirm the notice of decision; or

(ii) Modify the notice of decision and, if applicable, modify the Restructuring Commitment, in which event HUD will issue an amended or restated Restructuring Commitment that incorporates the final decision; or

(iii) Revoke the notice of decision and, if applicable, terminate the Restructuring Commitment and notify the owner that the owner is not eligible for participation in the Mark-to-Market program or that a restructuring of the property is not feasible.

16. Revise § 401.650 to read as follows:

**§ 401.650 When may the owner request an administrative appeal?**

(a) *No review request by owner.* If the owner does not request a review of the notice of decision under § 401.645 or does not execute the proposed Restructuring Commitment within the time provided in the notice of decision, HUD will send a written notice to the owner stating that the notice of decision is HUD's final decision and that the owner has 10 days after receipt of the letter to accept the decision, including a Restructuring Commitment if applicable, or request an administrative appeal in accordance with § 401.651.

(b) *Upon receipt of final decision.* HUD will send the owner a written notice of the final decision under § 401.645 that will also provide the owner with 10 days to request an administrative appeal of the final decision.

(c) *HUD decision to accelerate the second mortgage.* Upon receipt of notice from HUD of a decision to accelerate the second mortgage under § 401.461(b)(4), the owner may request an administrative appeal in accordance with § 401.651.

17. In § 401.651, revise paragraph (b) to read as follows:

**§ 401.651 Appeal procedures.**

\* \* \* \*

(b) *Written decision.* Within 20 days after the conference, or 20 days after any agreed-upon extension of time for submission of additional materials by or on behalf of the owner, HUD will review the evidence presented for the administrative appeal and, using the standard of whether the determination of the final decision was reasonable, will advise the owner in writing of the decision to terminate, modify, or affirm the original decision. HUD will act, as necessary, to implement the decision, for example, by offering a revised Restructuring Commitment to the owner.

\* \* \* \*

Dated: February 7, 2006.

**Brian D. Montgomery,**

*Assistant Secretary for Housing—Federal Housing Commissioner.*

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