CHAPTER 1. PRACTICES, PROCEDURES, AND RESPONSIBILITIES

Section 1. Introduction

1-1. General. Comprehensive servicing of insured project mortgages by mortgagees is of vital importance to program participants and to HUD. This handbook outlines servicing procedures consistent with well established industry standards. It sets forth, in one source, minimum requirements for servicing insured multifamily mortgages. Before the issuance of this handbook, HUD reviewed mortgagees to assure their compliance with HUD regulations and handbook requirements for servicing HUD-insured single-family mortgages only. This handbook expands that procedure and delineates responsibilities for HUD staff to use when reviewing mortgagees investing in and servicing multifamily mortgages. By following the provisions of this handbook, HUD staff and mortgagees should achieve the timely and proper servicing of mortgages that will reduce avoidable insurance fund claims. The information flows contemplated in this handbook should open new lines of communications between mortgagees and HUD's Field, Regional, and Headquarters staff. HUD hopes that the quality of servicing by mortgagees will be enhanced and that the ultimate profitability of servicing and holding mortgagees will be increased.

HUD continually strives to detect incidents of fraud and to reduce waste and mismanagement in its programs wherever possible. The latter chapters of this handbook describe the degrees of expected compliance with regulations, administrative requirements, and recommendations. Chapter 5 describes the "remote monitoring" procedures HUD Field Offices are to use and describes HUD's Regional and Headquarters Offices' involvement in the imposition of sanctions against insured, as opposed to coinsured, mortgagees. Chapter 6 deals with remedies and enforcement activities, lists the sanctions available to HUD, and briefly mentions the procedural steps HUD will follow when imposing sanctions on mortgagees.

1-2. Definitions:

a. Approved Mortgagee: A mortgagee that has been approved by HUD for participation in the HUD/FHA mortgage insurance programs upon filing a request for approval on a form prescribed by the Federal

Housing Commissioner. Approval of the application shall constitute an agreement between the mortgagee and the Commissioner that shall govern the mortgagee's continued approval. Approval may be restricted to participation in the Home Mortgage Insurance Programs or the Multifamily Mortgage Insurance Programs. Approval in either program may be restricted to geographic areas designated by the Commissioner.

b. Coinsuring Mortgagee: An approved mortgagee that has been further approved by HUD for participation in the Section 221(d)(3), 221(d)(4), 223(f), or 232 coinsurance programs under the provisions of 24 CFR Parts 251, 252, and 255, Subparts B, as they existed immediately before November 12, 1990, which is the effective date of the termination of the coinsurance program, and who shares the risk of loss.

c. Governmental, Quasi-governmental, and Federally Chartered Institutions and National Mortgage Associations: A federal, state, or municipal governmental agency, a Federal Reserve Bank, a Federal Home Loan Bank, the Governmental National Mortgage Association, the Federal National Mortgage Association, or any other institution that is empowered to hold mortgages insured under the National Housing Act. If it becomes an approved mortgagee it may submit applications for the insurance of mortgages and may purchase, hold, service, and sell insured mortgages. It may designate another approved mortgagee as its authorized agent for the purposes of servicing mortgages and submitting applications for mortgage insurance in its name and on its behalf to HUD.

d. Investing Mortgagee ("Holding" mortgagee): An approved mortgagee that is an organization that is not approved as another type of institution (e.g., Loan Correspondent, Servicing Mortgagee) and that invests funds under its own control. Such mortgagees include charitable and nonprofit institutions, pension funds, and trusts. It may purchase, hold, and sell HUD-insured mortgages, but it may not submit applications for the insurance of mortgages. It may not service HUD-insured mortgages without the prior approval of the Office of Lender Activities and Land Sales Registration (OLA) in HUD Headquarters but it shall arrange for the servicing of HUD-insured mortgages it acquires.

e. Loan Correspondent: An approved mortgagee that is an institution that lends or invests funds in real estate mortgages for sale to its sponsor(s). It may submit applications for the insurance of mortgages and may purchase, service, and sell HUD-insured mortgages. It may not retain insured mortgages in its own portfolio nor sell them to any mortgagee other than its sponsor(s) except with the prior approval of the HUD Field Office in whose jurisdiction the loan correspondent's office is located.

f. Mortgagee: The original lender under a mortgage and its successors and assigns, including the holders of credit instruments issued under a trust indenture, mortgage, or deed of trust pursuant to which such holders act by and through a trustee therein named.

g. Nonsupervised Mortgagee: An institution that has as its principal activity the lending or investment of funds in real estate mortgages and is not subject to the inspection and supervision of a governmental agency as described in the following definition of "Supervised Mortgagee." If it becomes an approved mortgagee it may submit applications for the insurance of mortgages and it may purchase, hold, service, and sell HUD-insured mortgages.

h. OLALSR: The Office of Lender Activities and Land Sales Registration located in HUD Headquarters. Henceforth, "OLA," or "Office of Lender Activities."

i. Participating mortgagee: A mortgagee that holds a partial interest in a HUD-insured loan; it is either an approved mortgagee or a corporation, trust, or organization that certifies to the principal mortgagee that it has assets of $100,000 or more and that it has lawful authority to acquire a partial interest in an insured mortgage.

j. Principal mortgagee: An approved mortgagee that transfers a partial interest in an insured mortgage that it holds to another approved mortgagee or to a qualified participating mortgagee as defined above.

k. Servicing mortgagee: An approved mortgagee or agent that is employed by the mortgagee holding a HUD-insured mortgage to do certain services on its behalf. These services may vary according to the agreement between the parties. The actions of any servicer will be considered by HUD to be the actions of the approved mortgagee holding the mortgage. A servicing mortgagee also may be the investing or holding mortgagee that has been specifically approved by OLA for servicing.

l. Special purpose mortgagee: There are two types of special purpose mortgagees:

(1) Public Housing Agencies for originating and holding insured project mortgages funded by issuance of tax exempt obligations of the agency.

(2) State Housing Agencies or insured depository institutions as defined in Section 244(g)(5) of the National Housing Act for originating and holding coinsured project mortgages pursuant to Section 244 of that Act.

m. Supervised mortgagees: There are two types of supervised mortgagees:

(1) Members of the Federal Reserve System (FRS) and institutions insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA).

(2) Other institutions, including affiliates of mortgagees supervised by the Comptroller of the Currency, that are subject to the inspection and supervision of a government agency that is required by law to make periodic examinations of its books and accounts.

If a supervised mortgagee becomes an approved mortgagee it may submit applications for the insurance of mortgages and may purchase, hold, service, and sell HUD-insured mortgages.

1-3. Purposes of servicing loans. A mortgage banker has two principal reasons for being in business: To originate loans (thereby making a profit from the loan origination fees and points) and to have an annuity in the form of a servicing portfolio. Of these two the latter is usually the more significant for most lenders. After the loan is closed and finally endorsed for mortgage insurance, it is usually sold by the originating lender. The loan may be sold as a "whole loan," transferring to the new owner all the former mortgagee's rights. It also may be sold on a "servicing retained" basis, where the seller retains the right to service the account for the investor. Retaining servicing rights or acquiring servicing rights from an investor represents a predictable future income stream for the loan servicer.

1-4. Servicers are usually paid a percentage of the monthly loan installment by the holder of the mortgage when the servicer provides a full range of loan administration services, such as collecting payments from the mortgagor, analyzing tax and insurance escrow requirements and maintaining such escrows, ensuring the preservation of physical security by conducting physical inspections, and by determining that adequate insurance is always in effect. In other instances the holding mortgagee may contract with an agent for more limited servicing activities, such as conducting the required annual physical inspections of the physical security (the HUD Project). It might do so because the agent may have been the originating mortgagee, commonly located closer to the project than is the investor. Fees are usually earned in such instances according to a mutually agreed fee schedule.

An additional source of revenue for the servicer is the float -- the use of the funds from the time they are received from the mortgagor until the funds must be remitted to the investor. Remittances to investors may be required daily, weekly, or monthly; such requirements are a matter for the investing and the servicing mortgagee to decide. For instance, mortgage-backed securities require only a monthly remittance to certificate holders. Mortgage servicing, then, can be a profitable endeavor, particularly when servicing costs are minimized.

1-6. The investing mortgagee, the servicing mortgagee, the mortgagor, and HUD unite to form a team whose goal is to provide an adequate supply of affordable housing for our nation. This housing is, of course, to be provided on a nondiscriminatory basis. As with any team, the extent of cooperation among its members is as important to achieving success as are the skills of each member. The formal relationships among the members of the housing team are contractually controlled, but the day-to-day relationships are complex, diverse, and sometimes conflicting. By way of example, mortgage interest rates are ordinarily established by market forces. Mortgagors and builders need low interest rates to increase their profitability when developing or owning a project (or to keep rental rates lower for non-profit mortgagors) while lenders need interest rates that are higher than their costs of attracting capital. The higher the point spread between a lender's cost of capital and the interest rate it charges a borrower, the greater its profit margin. But high interest rates are ultimately passed on to the individual consumer, whether a tenant of a rental project or an occupant of a unit under a cooperative or a condominium form of ownership. When the interest rate is high the debt service burden is greater than when the interest rate is lower; this results in housing available to a smaller segment of society than if interest rates were lower.

1-7. HUD Provides assistance through interest subsidies as in the cases of the Section 236 program or the Below Market Interest Rate (BMIR) program under Section 221(d)(5). Here the benefits of the subsidized

mortgage accrue directly to the mortgagee and mortgagor and indirectly to the occupants of the units. In other instances HUD may choose to provide project-based subsidies in the forms of rental assistance under the Section 8 program or other similar programs. Here the benefits of the subsidy accrue more directly to the tenants and the mortgagors and indirectly to mortgagees.

1-8. Through the various programs of multifamily mortgage insurance, HUD eases the flow of capital from lenders to borrowers by enabling loans that have lower equity requirements for borrowers than loans that are conventionally financed. Non-recourse loans stimulate borrowers to borrow money to develop and own projects; lenders, limited exposure to loss further stimulates lending. By acting as the mediator when many inherent conflicts between the mortgagee and the mortgagor arise, HUD protects its interests as the insurer of the loan and attempts to improve the working relationships among the other team members.

1-9. HUD's relationship with the mortgagor involves many duties and responsibilities for both HUD and the mortgagor. While protection of the contingent liability of the Secretary is paramount in all asset management (project servicing) activities taken by HUD, the Department exercises care to prevent undue, unwarranted, or unauthorized intervention in the affairs of the mortgagor. The terms of the Mortgage, Regulatory Agreement (or Charter), Mortgagor's Certificate, and the provisions of HUD handbooks set forth the rights and responsibilities of both parties. HUD fosters good project servicing by providing friendly and cooperative assistance to the mortgagor, but the business relationship between HUD and the mortgagor demands strict adherence by both parties to the full discharge of their duties.

a. Among many asset management (project servicing) duties, HUD is responsible for authorizing releases from the Reserve Fund for Replacements and Residual Receipts escrow accounts, for authorizing alterations, modifications, or additions to physical structures, for authorizing partial releases of security and changes in ownership, and for establishing rental rates in most projects.

b. HUD also may intercede with the mortgagee on behalf of the mortgagor when asked to do so by the mortgagor. It is the practice of HUD to keep the mortgagee informed about asset management actions taken by HUD or requested by the mortgagor.

c. HUD conducts management reviews of most projects and gives the owner advice and guidance on the management and operations of projects.

d. By these actions HUD attempts to protect the physical security of the project, to preserve the financial soundness of the mortgagor, and to assure that the tenants have safe, sanitary, well maintained musing. In exchange for these benefits, the mortgagor agrees to provide HUD with audited annual financial statements, to provide for the effective management and maintenance of the project, and to comply with other program requirements.

1-10. Both the investing and the servicing mortgagees exercise direct control over the mortgagor through the Mortgage and the Note and indirect control (with the involvement of HUD) under the Regulatory Agreement. Mainly because the Regulatory Agreement is an agreement between the mortgagor and HUD, mortgagees have traditionally considered enforcement of its provisions a matter between HUD and the mortgagor. Similarly, because the Note and the Mortgage are agreements between the mortgagor and the mortgagee, mortgagees are chiefly responsible for obtaining compliance with the covenants of these instruments. Mortgagors typically interact with only the servicing mortgagee; mortgagors may often not even know that a mortgagee other than the servicing mortgagee is involved. Some major controls exercised over mortgagors by mortgagees include the following restrictions:

a. The mortgagor must Pay sums due under the controlling instruments to the mortgagee, must maintain the Physical condition of the Property, and must use it as intended.

b. The mortgagor must keep fire and other hazard insurance in force.

c. The mortgagor must furnish audited annual financial statements to the mortgagee.

d. The mortgagor will not permit the creation of other liens, inferior or superior.

1-11. The mortgagee, on the other hand, has several obligations to the mortgagor. For instance,

a. The mortgagor must prepare and submit to HUD and to the mortgagee audited annual financial statements, usually within sixty days after the end of its fiscal year. Accordingly, the mortgagee must furnish the mortgagor with confirmations of the account in time for the mortgagor to fulfill its responsibilities.

b. The mortgagee must permit the investment of the mortgagor's money held in the Reserve Fund for Replacements and the Residual Receipts trust accounts.

c. The mortgagee should analyze tax and insurance escrow account requirements with sufficient accuracy so that there are sufficient funds held in escrow to pay sums due at least one month before the date such sums would become delinquent while taking care that excessively large surpluses do not accrue.

d. The mortgagee must provide the mortgagor a Satisfaction of Mortgage upon full payment of the Note, its interest, money advanced, late charges, commissions, etc.

1-12. The mortgagee/mortgagor/HUD relationship is interdependent. Effective teamwork is essential when certain forms of financial relief are being considered.

a. For example, HUD and the mortgagee must jointly decide and may agree to modify an existing insured Note and Mortgage upon a request from the mortgagor; if the mortgage is to be modified, neither HUD nor the mortgagee may do it alone.

b. The parties must reach a similar understanding for the holding and servicing mortgagees to hold a mortgage under a workout arrangement proposed by a mortgagor whose mortgage is in default. For instance, if HUD should decline to extend the deadline for the investing mortgagee's assignment election, a portion of the mortgagee's insurance benefits could be jeopardized if the deadline passes without making the election decision.

c. The mortgagees and HUD also must work together when approving requests from mortgagors for transfers of physical assets, partial releases of security, property insurance loss drafts, and in countless other ways. For another example, mortgagees occasionally receive requests from mortgagors for the mortgagee to permit secondary financing. When the proposed secondary financing is to be provided by State Finance Agencies or by the National Cooperative Bank, HUD and the mortgagor would be appreciative if the mortgagee processes these requests with minimal charges to the mortgagor.

d. Mortgagees and HUD must work together when there is a monetary or covenant default of the mortgage or Regulatory Agreement. If there is a mortgage default the mortgagee most interact with HUD to ensure that it meets all regulatory requirements for declaring a default, electing to assign the mortgage, and in seeking extensions of deadlines. If there is a default under the Regulatory Agreement the mortgagee must cooperate with HUD if HUD requires the mortgagee to accelerate the mortgage.

1-13. The ultimate responsibility for mortgage servicing rests with the holding mortgagee and it cannot be delegated to anyone. Servicing tasks, however, may be accomplished under a contractual arrangement between holding mortgagees and servicers. HUD does not enter or intervene in these contracts. Essentially, the investing mortgagee pays the servicing mortgagee to provide an array of services to the mortgagor.

Investors want low delinquency ratios on their portfolios. Investors may be somewhat more inclined to assign a defaulted mortgage to HUD than might the servicer, who loses the servicing income for that mortgage upon assignment. On the other hand, troubled accounts have a much more intensive level of servicing efforts with a corresponding increase in servicing costs. Servicers typically conduct a wide range of activities for their investors. Servicers provide the liaison between the investor and the mortgagor as well as between the investor and HUD. Mortgagors almost never deal with their investors directly. HUD, on the other hand, communicates directly with both investors and servicers.

Section 2. Applicability

1-14. The following Table shows the Sections of the Act to which this handbook applies. (Reminder: Operating Loss loans are insured under the mortgage insurance program of the underlying first mortgage.)

Table 1. Mortgage Insurance Programs

Section Number	Program Description
207M	Mobile Home Courts
207	Multifamily Rental Housing, Pre-War Legislation
207	Formerly HUD-held Mortgages Sold with Insurance
207/223(c)	Formerly HUD-owned Projects
213S	Sales and Investor Cooperatives
213M	Management Cooperatives
213(i)	Consumer Cooperative
220	Urban Renewal/Declining Area Rental Housing
221(d)(3)	Market Rate, Moderate Income Families
221(d)(4)	Market Rate, Moderate Income Families
221(d)(5)	Below Market Interest Rate (BMIR)
221(h)	Rehab. Sales Projects
223(e)/220	Rehab./Refinance Existing, Declining Neighborhood
223(f)/207	Purchase/Refinancing Existing Housing
231	Housing for the Elderly
232	Nursing Homes, Intermediate Care Facilities
233	Experimental Housing
236	Housing for Lower Income Families
241	Supplemental Loans (Capital Improvement/Equity Takeout)
242	Hospitals
Title XI	Group Practice Facilities

1-15. All investing mortgagees and servicing mortgagees holding or servicing mortgages finally endorsed under any of the Sections of the Act shown in Table 1 are subject to the provisions of this handbook. Other multifamily mortgage insurance programs may be added from time to time; mortgagees involved in these programs will be subject to this handbook unless specifically and expressly excluded.

Section 3. Mortgage Servicing, General Guidance

1-16. This handbook establishes certain minimum mortgage servicing requirements and standards. It also describes other servicing duties and responsibilities that, though only recommended, HUD believes to be necessary for the effective and acceptable servicing of mortgages. It provides some refinements to the existing general practices of the Department regarding loan administration activities for insured mortgages, and emphasizes which of the Department's policies and regulations regarding the servicing of single-family mortgages also pertain to multifamily mortgage insurance programs. In one source, it formalizes many procedures established by various Mortgagee Letters, Notices, and other instructions issued over the years.

1-17. Regulatory Authority. The underlying regulations for servicing practices for all multifamily mortgage insurance programs are in Title 24 of the Code of Federal Regulations in Part 207. Some key sections are below.

a. Section 207.2 subjects fees and charges to mortgagors by mortgagees to HUD approval.

b. Section 2072.3 provides for mortgage provisions to be contained in a form of mortgage approved by HUD.

c. Section 207.13 establishes the application of payments received from mortgagors.

d. Section 207.14(c) allows the assessment of Late Charges.

e. Section 207.19(b)[i](B) addresses the Reserve Fund for Replacements.

f. Section 207.22 incorporates the provisions of Section 202.11 through 202.14 and 202.16 through 202.19 by reference to govern the eligibility, qualifications, and requirements of mortgagees under Subpart A of Part 207.

g. Section 202.12(f) requires compliance with servicing responsibilities found at Part 207. Section 202.12(f) also requires compliance with all other applicable regulations contained in Title 24 and with such other additional conditions and requirements as HUD may impose.

Section 4. Mortgagee Monitoring, General Procedures

1-18. This handbook sets forth the practices and responsibilities for conducting reviews of approved multifamily mortgagees, and agents. HUD reviews mortgagees' procedures to assure their compliance with HUD regulations and handbook requirements when servicing HUD-insured multifamily mortgages. When HUD conducts an on-site mortgagee review, HUD shall monitor mortgagee servicing practices.

a. HUD will determine the mortgagee's compliance with the requirement to conduct quarterly rating reviews of banking institutions where there are escrows in excess of $100,000. If the mortgagee has not performed the required rating reviews at institutions where there are deposits in excess of $100,000, the mortgagee shall be cited as being in noncompliance and will be subject to sanctions if the situation is not corrected immediately. In addition, the mortgagee should be reminded that in the event the required rating review is not completed, and the banking institution fails, the mortgagee is expected to replace any lost funds.

b. If the mortgagee fails to conduct the required rating review. HUD will use all available remedies to recover whatever funds are lost as a result of the failed institution and the mortgagee's failure to replace the lost funds.

1-19. Mortgagee reviews are mandatory. Remote monitoring reviews are conducted by HUD Field Office Housing Management staff. Housing Management personnel monitor mortgagee servicing practices to:

a. Open and maintain communications between the mortgagee's staff and HUD's staff.

b. Improve the mortgagee's performance through technical assistance.

c. Assure timely and proper servicing of mortgages so that unnecessary claims against the insurance funds do not result.

d. Decide the degree of compliance with HUD servicing requirements by examining the mortgagee's servicing policies, practices, and procedures and their results.

e. Protect HUD's interest by detecting, reporting, and preventing fraud, waste, and mismanagement.

f. Identify mortgagees to recommend to the Inspector General for possible audits.

g. Identify mortgagees that the Mortgagee Review Board should consider for the imposition of sanctions. These sanctions include:

1. Reprimand
2. Probation
3. Suspension

4. Withdrawal of Approval
5. Civil Money Penalties

1-20. The Loan Management Branch staff in HUD Field Offices make in-house "remote" reviews of mortgagees' practices. An example of one such activity is monitoring the receipt of annual physical inspections due HUD from mortgagees and comparing the findings of these physical inspections with other known project information. Another example is identifying compliance with mortgagees' reporting of mortgage delinquencies and defaults. The Loan Management Branch Chief provides the final results of the remote monitoring review to:

a. The Mortgage Credit Branch Chief of the Field Office as a courtesy and for his information.

b. The Regional Director of Housing. The Regional Director of Housing reviews the results of these reviews and forwards sanction recommendations to the Director, Office of Multifamily Housing Management (Attn: Operations Division) in HUD Headquarters.

1-21. The Office of Lender Activities (OLA) has the task of referring cases of serious mortgagee infractions to the Mortgagee Review Board or the Housing Civil Money Penalties Panel for the imposition of sanctions. OLA, in the capacity of Secretariat for the Board and the Panel, receives sanction recommendations from the Multifamily Housing Management Operations Division.

1-22. The Mortgagee Review Board and the Housing Civil Money Penalties Panel have sole authority for the imposition of sanctions against insured (as opposed to co-insured) multifamily mortgagees.