

Legal Opinion: CIM-0120  
Index: 3.350 & 4.260  
Subject: Section 236 Preservation Proposal  
Wollaston Manor  
Quincy, MA

July 19, 2000

MEMORANDUM FOR: Frank M. Malone, Director,  
Office of Multifamily, Asset Management, HTO

FROM: John J. Daly, Associate General Counsel  
for Insured Housing, CI

SUBJECT: Section 236 Preservation Proposal  
Wollaston Manor  
Quincy, MA

This memorandum responds to your July 7, 2000 request for legal advice concerning a preservation proposal that was sent to your Office from the Massachusetts Alliance of HUD Tenants (MAHT). You asked whether the subject project can refinance its section 236 mortgage, under the authority of section 236(e)(2) of the National Housing Act (NHA), and maintain not only its IRP assistance (which section 236(e)(2) expressly authorizes) but also its Rental Assistance Payment (RAP) assistance (which section 236(e)(2) provision does not address). The purpose of RAP under NHA section 236(f)(2) is for HUD to provide a subsidy on behalf of tenants who cannot afford to pay the section 236 basic rent.

We believe that there is authority under section 236(e)(2) for HUD to continue RAP payments after a refinancing. Section 236(e)(2) provides that a project shall continue to receive IRP after a refinancing if the owner commits to:

continue to operate the project in accordance with all low-income affordability restrictions for the project in connection with the Federal assistance for the project for a period having a duration that is not less than the term for which such interest reduction payments are made plus an additional 5 years.

We construe this provision as requiring that IRP be maintained at a project that consummates a section 236(e)(2) refinancing only if other section 236 statutory and regulatory requirements continue to operate (e.g., the establishment of a basic rent (NHA section 236(f)(1)), return to HUD of excess

income (NHA section 236(g)), etc.). See Notice H 00-8 (HUD) (Issued 5/16/00). The RAP authority in section 236(f)(2) for tenants whose income is too low to pay basic rent is a fundamental part of the section 236 program and helps make it possible for such tenants to be able to maintain occupancy in a section 236 project. After a section 236(e)(2) refinancing, basic rent requirements will continue. While section 236(e)(2) is silent on the issue, we think it is reasonable to view Congress as having intended, through section 236(e)(2), to permit the continuation of RAP as long as other section 236 requirements, such as those pertaining to the establishment of basic rent and RAP (where applicable), are satisfied.

Notwithstanding the above, we must caution that the current form of RAP contract (FHA Form No. 3105) provides for a term that would end upon a prepayment of a mortgage. See Section 4, which provides:

Term -- This Contract shall continue until the termination or maturity of the mortgage on the Project (*hereinafter called the "Mortgage"*), or 40 years from the date of the first Rental Assistance Payment made hereunder, whichever occurs first.

The HUD regulation at 24 CFR 236.725 provides:

The rental assistance contract shall be limited to the term of the mortgage or 40 years from the date of the first payment made under the contract, whichever is the lesser.

Since the RAP contract expressly provides for a termination of RAP upon a mortgage prepayment and reflects the Department's implementation of the regulation, we think the intent of the regulation is that, if a mortgage is prepaid, its term is completed so that termination of the RAP assistance is triggered. Therefore, what needs to be done for RAP to continue after a section 236(e)(2) refinancing is the following:

- (1) the actual RAP contract should be modified, prior to a mortgage prepayment, to insert a provision for the continuation of the RAP subsidy, and
- (2) the Assistant Secretary for Housing must issue a waiver of 24 CFR 236.725 prior to such prepayment.

If Housing's policy is to waive that regulation for all projects that carry out a section 236(e)(2) refinancing, Housing should revise 24 CFR 236.725 in order to insert a provision for continuation of RAP after a prepayment resulting from a refinancing. To the extent that such a regulatory amendment cannot be consummated before transactions under section 236(e)(2) require continuation of RAP, we suggest following the model used in H 99-15 (6/16/99), entitled "Emergency Initiative to Preserve

Below-Market Project-Based Section 8 Multifamily Housing Stock." In order to permit distributions in excess of a regulatory limitation on distributions to limited dividend owners, OGC concurred in the Assistant Secretary issuing a waiver for all projects that fell within the waiver category but with a date limitation so that the waiver could not be construed as rulemaking in violation of the notice and comment requirements of the Administrative Procedure Act. Simultaneously, Housing requested OGC's Regulations Division to draft a regulation that would permit an increased distribution for projects that qualified for the emergency initiative. To the extent's Housing's intention is to permit continuation of RAP after a section 236(e)(2) refinancing, we recommend use of a waiver of the requirement 24 CFR 236.725 through a procedure like that used with the emergency initiative for distributions (e.g., with a date certain limitation and with a request from Housing to OGC's Regulations Division for a regulatory amendment).

You also asked in your July 7, 2000 memorandum about rent supplement assistance. For the reasons expressed above in connection with RAP assistance, we believe that there is authority under section 236(e)(2) for HUD to continue rent supplement assistance payments after a refinancing. The rent supplement regulation at 24 CFR 215.35 (rev. April 1, 1995), which was saved by 24 CFR 200.1302(a) in the current CFR, and section 4 of the form Rent Supplement Contract (FHA Form No. 2503) have language that is the same as that in the RAP regulation and form RAP contract described above. To permit a continuation of rent supplement assistance after a section 236(e)(2) refinancing, there would need to be an amendment to the rent supplement contract and a waiver of the rent supplement regulation. If Housing's policy is to waive the regulation at 24 CFR 215.35 for all projects that carry out a section 236(e)(2) refinancing, there also would need to be an amendment to that regulation to permit a continuation of rent supplement assistance after a prepayment as a result of a section 236(e)(2) refinancing.

Howard Mayfield of your staff asked us orally to note in our response that, in section 236(e)(2) transactions, there may be owners who want not only to continue RAP but also to request RAP increases as a result of, among other things, rent increases. As Mel Belin of my staff advised him orally, we would have to do further analysis to assess whether RAP increases would be authorized in the particular context in which the owner makes the request. We also would need to perform similar research if an owner wanted to request rent supplement increases after a section 236(e)(2) refinancing. Please send us a memorandum describing the details of any proposed transactions if you desire written legal advice on this matter.

Please contact Mel Belin at ext. 5254 if you have any questions about this memorandum or desire further assistance.