

the waiver is essential to meet the legitimate business or legal requirements of the provider of credit enhancement.

§ 401.461 HUD-held second mortgage.

(a) *Amount.* If the Restructuring Plan provides for payment of a section 541(b) claim, the Plan must also provide for a second mortgage to HUD in an amount that does not exceed the amount that the PAE reasonably expects to be repaid based on objective criteria such as the amount of anticipated net cash flow, trending assumptions, amortization provisions, and expected residual value of the project. The second mortgage also must not exceed the difference between the unpaid principal balance on the first mortgage immediately before and after 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. Interest will accrue but not compound.

(2) The second mortgage must have a term concomitant with the modified or refinanced first mortgage. HUD may provide that if the first mortgage of a nominal amount is satisfied, the second mortgage may continue for a term established by HUD.

(3)(i) Principal and interest on the second mortgage is payable only out of net cash flow during its term. "Net cash flow" means that portion of project income that remains after the payment of all required debt service payments on the modified or refinanced first mortgage, if any, including payment of any past due principal or interest, and payment of all reasonable and necessary operating expenses (including deposits to the reserve for replacement account) and any other expenditure approved by HUD.

(ii) The priority and distribution of net cash flow is as follows:

(A) HUD or the PAE may approve the payment to the owner of up to 25 percent of net cash flow based on consideration of relevant conditions and circumstances including, but not limited to, the project management meeting the management standards prescribed in § 401.484 and the project meeting the housing quality standards prescribed in § 401.453; and

(B) All remaining net cash flow will be applied to the principal and interest on the second mortgage, until paid in full, and then to any additional subordinate mortgage under § 401.461(c).

(4) HUD may cause the second mortgage to be immediately due and payable on the grounds provided in section 517(a)(4) of MAHRA, including an assumption of the mortgage in violation of HUD standards for approval of transfers of physical assets (if applicable), or if the owner fails to comply with other HUD requirements after a reasonable opportunity for the owner to cure such failure. A decision by HUD in this regard is subject to the administrative appeals procedure in subpart F of this part.

(5) HUD will consider modification or forgiveness of all or part of the second mortgage only if the project has been sold or transferred to a priority purchaser under § 401.480 and HUD determines that modification or forgiveness is necessary to recapitalize the project in order to preserve it as affordable housing.

(c) *Additional mortgage to HUD.* If the amount of a section 541(b) claim under § 401.471 exceeds the principal amount of the second mortgage, a Restructuring Plan may require the owner to give an additional mortgage on the project to HUD to secure repayment of that portion of the claim that is not already secured. This additional mortgage must be junior in priority to the second mortgage required by paragraph (a) of this section, bear interest at the same rate which will accrue but not compound, and require no payments except payment in full when the second mortgage is satisfied.

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§ 401.471 HUD payment of a section 541(b) claim.

HUD will pay a section 541(b) claim from the appropriate insurance fund to the insured mortgagee on behalf of the mortgagor to reduce the principal balance of the insured mortgage as provided in the Restructuring Plan. All section 541(b) claims will be paid in cash. Part 207 of this title and sections 207(g) and 541(a) of the NHA do not apply to a section 541(b) claim.