

**Multifamily Rental Project Closing Documents
HUD Responses to Some of the More Significant Comments and
Technical Issues Raised in Connection with the 30-Day PRA Notice**

Program Obligations

A definition of “Program Obligations” is included in several of the closing documents, e.g. the Security Instrument, (the Mortgage), and the Regulatory Agreement. The Regulatory Agreement sets forth the requirements that an owner must meet over the term of the HUD loan. The definition of Program Obligation identifies the specific, longstanding, and familiar types of requirements--those in statutes, regulations, handbooks, notices, and mortgagee letters) to which the parties must adhere.

Comment

- Commenters repeated concerns raised in response to previous notices that HUD appeared to have unfettered discretion to make future material changes to policies, and requested HUD include a materiality standard.

Response

- HUD did not include a materiality standard as requested by the commenters. If adopted, a materiality standard would invite individual disputes about the application of certain provisions in the documents that may have a material effect on one Borrower but not on another. Instead, HUD included language clarifying that notice and comment rulemaking procedures are used for significant substantive requirements, as such is the case in practice.

Comment

- Commenters repeated concerns raised in response to previous notices that HUD policy changes will be applied to existing Borrowers that could have an financial effect on the operation of a Project

Response

- HUD has revised the definition of Program Obligations to clarify the process by which policy changes would be applicable. In this regard, the definition is revised to make explicit that:

- o Changes subject to notice and comment rulemaking become effective only upon completion of the rulemaking process.
- o Future updates, changes and amendments shall be applicable to the Project only to the extent that they interpret, clarify and implement terms in the particular document rather than add or delete provisions from the document.

Treatment of Reserves and Escrows

Several of the documents, namely the Security Instrument, the Regulatory Agreement and the Escrow documents, establish requirements for where borrowers will place reserve funds and restrict investment categories.

Comment

- Commenters stated that the policies in the documents providing investment policies for reserves and escrows represent a departure from current policy. They contend that the policies interfere with the business relationship between the Lender and Borrower, and restrict the liquidity of the reserves. The lenders contend that (1) requirements that escrows be deposited only in accounts fully insured by the United States of America would create administrative costs and difficulties, and (2) the low limit on insured accounts would require breaking up certain reserves or escrows into multiple insured accounts.

Response

- HUD removed restrictions in the documents that required investment in US Treasury securities, and substituted a requirement that funds be held in accounts insured by federal supervisory agencies, e.g. the FDIC and NCUA.
- As is the current case, HUD will allow the Lender and the Borrower to negotiate appropriate fees for administration of reserves and escrows.

Liability of Principals

Although HUD is moving to allow a single asset form of borrower, HUD had proposed that “principals” be responsible for certain “Bad Boy Acts.”

Comment

- Commenters claimed that individuals should never be personally responsible for any of the financial or management aspects of the multifamily projects.

Response

- HUD, consistent with its commitment to modify key terms only in the rulemaking process, included a definition of Principals in the Security Instrument. That definition cites directly to the regulation.--24 CFR 200.215. Thus, any Security Instrument contract will always reference the current regulation.
- HUD is also requiring that key Principals sign the Regulatory Agreement. Signing Principals should be personally responsible for paying damages for certain “bad boy” acts as exceptions to the nonrecourse provisions of the Note.
- Principals required to sign the documents are, in general, attesting only “to the best of their knowledge,” and primarily to their own statements and representations.

The Lender’s Certificate

The Lender’s Certificate lists the certifications made by the Lender to HUD regarding the responsibilities the lender has completed in performing the due diligence necessary to complete final underwriting of the project.

Comment

- Commenters were concerned that they would have to absolutely certify that the Borrower possessed all necessary governmental certificates, permits, licenses, qualifications and approvals of Governmental Authorities to own and operate the Mortgaged Property, and to carry out all of the transactions required by the Loan Documents, and to comply with applicable federal statutes and regulations of HUD in effect on the date of the Firm Commitment. Commenters stated that in commercial transactions, these issues would be addressed in representations and warranties made by the Borrower instead of the Lender. With respect to HUD transactions, commenters stated it has been the responsibility of the Borrower (and its counsel) to provide evidence of compliance.

Response

- HUD adopted the following modifications which narrow the liability tests::
 - The Lender certifications will be based upon reasonable due diligence,” and
 - The Lender will certify that they have made reasonable inquiry” or is certifying “to the best of Lender’s knowledge.”
- The Lender will confirm, (as opposed to certifying) in writing before final endorsement of the Note that the Borrower has obtained the necessary permits and met the listed requirements.

Guide for Opinion of Borrower’s Counsel

The Guide is the legal opinion that the borrower’s attorney gives to the Lender prior to closing to provide the Lender with protection that the borrower is legally formed, has the authority to enter

into the mortgage, and can execute the closing documents. The Lender requests this opinion because the lender will frequently depend on the borrower and its counsel to provide them with accurate and complete information on many aspects of the law in the applicable jurisdiction, as well as the borrower's legal status.

Comment:

- Commenters stated that it was impossible to obtain certificates of good standing for trusts in certain jurisdictions.

Response

- HUD will allow attorneys to provide alternatives appropriate for the jurisdiction and the entity, and will allow the participating entities to certify their legal status.

Comment

- Commenters stated that the conflicts test, under which attorneys certify that they, for example, have no financial interest or conflict in the project or connection to the borrower, was too narrow and prohibited many attorneys and law firms from being able to give opinions on the viability of the deals. For example, commenters stated that because they might perform some kind of legal work for Wells Fargo, such as employment litigation, they would be prohibited from rendering opinions under the conflicts tests.

Response

- HUD revised the document to provide that the conflicts test is applicable to "only those attorneys who devote substantive attention to the transaction", and does not apply to other lawyers in the firm. HUD also narrowed the conflicts test to provide that the participating attorneys will base their opinion on their own knowledge of other firm attorneys' financial interest and conflicts in the Project, the Property, or the Borrower

Comment

- Commenters contend that individual lawyers typically did not sign the opinion, and that instead, lawyers signed on behalf of their firm.

Response

- HUD decided to allow the Opinion to be signed on behalf of the firm issuing the Opinion rather than by an individual counsel.

Borrower's Certification

The Borrower's Certification is the HUD document comparable to the Borrower's Affidavit in commercial lending transactions. In this document, the borrower reaffirms certain information provided to the lender, and represents to both the lender and the title insurance company that is insuring the property that they are aware of facts related to the property.

Comment

- Commenters were concerned that the certification would cover many parties to the transaction, such as parties with minor financial interests, who could fall into a category where they would be personally responsible for signing the documents,

Response

- HUD narrowed the parties who would most likely be held responsible for these warranties to the general partner, managing member, or similar person or entity, not parties who might have minor financial interests. The parties responsible for signing will be specified in more detail in a definition of Principal that will be developed in the forthcoming guidance.

Response

- HUD narrowed the required warranties to provide that the borrower is only required to attest to pending litigation and claims against that narrower category of liable parties, versus the comprehensive universe of parties.