



**U.S. Department of Housing and Urban Development**  
New York State Office  
Jacob K. Javits Federal Building  
26 Federal Plaza  
New York, New York 10278-0068

## **SECONDARY FINANCING BY PUBLIC BODIES**

### **HUD NOTICE H95-38**

Many projects require secondary financing from public bodies to supplement the Section 202 or 811 Capital Advance. The attached Notice H95-38 summarizes the requirements for secondary financing documents.

Do not enter into any secondary financing agreements until draft documents have been submitted to and reviewed by our Office. Further, the secondary financing documents may not include provisions by which the Section 202 or 811 owner corporation indemnifies the secondary lender.



HOUSING

Special Attention of:

**Notice** H 95-38 (HUD)

All State and Area Coordinators,  
All Directors of Housing,  
All Multifamily Housing Directors

Issued: 05/03/95  
Expires: 05/31/96

Cross References:

Notice 90-1

Subject:

Secondary Financing by Public Bodies for Section 202  
and 811 Projects

I. Purpose: The purpose of this Notice is to advise offices of the Department's policy regarding the use of Public Body funds for secondary financing of Section 202 and Section 811 projects.

II. Background: Sponsors of Section 202 and 811 projects continue to approach state and local public bodies for secondary financing due to problems related to front end cash requirements and cash requirements related to project management. Public bodies have expressed interest in providing such financing on favorable terms. The Department is willing to entertain such requests. Previously (per H 90-1 HUD, as reinstated) each such request was to be submitted to Headquarters, along with the proposed mortgage documents, for approval on a case-by-case basis. Secondary financing by other than public bodies may be authorized on a case-by-case basis. Such proposals must be submitted to Headquarters for review and approval.

III. Policy: In order to expedite the handling of such requests and to deliver these services in accordance with revised delegations and redelegations of authority to the HUD State and Area Offices, each such request is to be submitted to the appropriate State or Area Office for review and approval. The Chief Counsel for that Office will review the secondary financing documents and make recommendations to the appropriate Multifamily Housing Director. The State or Area Multifamily Housing Director will review the comments from the Chief Counsel and request the owner/borrower to make modifications to the documents as appropriate.

HMR : Distribution: W-3-1, W-2(OGC)(H)(Z), W-3(A)(H)(ZAOO), W-4(H), R-1, R-3,  
R-3-1(H)(RC), R-3-2, R-3-3, R-6, R-6-1, R-6-2, R-7, R-7-1, R-2, R-8, R-8-1

First, the documents must be determined by the Chief Counsel to be legally acceptable, then, the secondary financing documents are reviewed by the State or Area Multifamily Housing Director. The documents are approvable by the State or Area Multifamily Housing Director if:

- (1) It is by a public body.
- (2) It does not become due and payable in whole or in part until the Section 202 or 811 capital advance (mortgage and note) is fully amortized, except in the following two cases:
  - (a) payments can be made on the second mortgage prior to full amortization from Residual Receipts, to the extent available after approval by the local HUD Office; or
  - (b) the sponsor agrees to make payments from its own funds, and such funds do not come from the Section 202 or 811 project.
- (3) The Owner/Borrower's compliance with HUD requirements satisfies the requirements of the second mortgage holder. The second mortgage holder cannot impose any requirements which interfere or conflict with HUD's requirements concerning the project's development or operation; nor can they in any way jeopardize the continued operation of the project on terms at least as favorable to existing as well as future tenants.
- (4) No default under the second mortgage is declared without HUD approval.
- (5) HUD approval of a Transfer of Physical Assets (TPA) constitutes approval of the TPA by the second mortgage holder.


Secondary financing by public bodies in Section 202/811 projects may be used for any purpose related to development and/or management of the project, except for the minimum capital investment or items that would change the character of the project, such as nursing stations. Examples of items that could be covered by such secondary loans are excess land costs, unusual off-site costs, excess amenities and the cost of major structural repairs. Examples of items that would not be permissible for inclusion in secondary loans would be amenities that would raise the operating expenses such as swimming pools (unless the owner is prepared to pay such operating expenses out of its own or other non-HUD funds).

The only exception to the above policy involves the Department's Community Development Block Grant (CDBG) Program.

Under certain circumstances, CDBG funds may be used to provide second mortgages. Where cities wish to use this authority for making second mortgages, using their entitlement grants or their distributions from State grantees, they may do so. However, the mortgage reduction procedure would be used for the HUD mortgage to the extent necessary to assure that HUD funds are not being used to finance excess amenities. The mortgage reduction process would not be used in cases where the public body providing the second mortgage receives CDBG funds but the funds being used for the subject project are not CDBG funds.

Often as part of the closing of a Section 202 or 811 capital advance, the approval of secondary financing is necessary. The State or Area Office should use the same criteria and review requirements as described above. With HOME secondary financing, a waiver request of the HOME Program rent requirements found in the HOME Regulations at 24 CFR Section 92.252 (a)2, must be submitted to the Assistant Secretary for Community Planning and Development, Attention: Office of Affordable Housing, at Headquarters for approval.

Due to the limited staff resources in the local HUD offices and the need for Field Counsel review of loan documents, Owners/Borrowers and lenders are encouraged to keep documents as brief as possible. Any questions concerning this policy may be directed to Margaret Milner at 708-4542.

  
Assistant Secretary for Housing-  
Federal Housing Commissioner