CHAPTER 24. OPERATING LOSS LOANS

24-1. Introduction. Pursuant to Section 223(d) of the National Housing Act (and applicable HUD Regulations for that Section of the Act under which the multifamily project is insured), the mortgagor may request and the Commissioner may insure a loan to cover operating losses of certain projects that have existing project mortgages insured by the Secretary (including projects which have formerly coinsured mortgages). Housing Development and Housing Management Divisions of the Field Office play different roles in the processing of operating loss loans. While Housing Development directs the processing of the application for an operating loss loan, Housing Management provides information for this processing and may monitor disbursement on a post-endorsement basis. Field Offices should refer to HUD Handbook 4470.1 for complete processing instructions for operating loss loans.

24-2. General Information Regarding Operating Loss Loans.

A. Eligibility of the Mortgagor. To be eligible for an operating loss loan, the following conditions apply:

1. The existing project mortgage must be insured by the Secretary under the National Housing Act and must include at least: 5 units (rental or cooperative); 5 rental spaces (manufactured home parks); 20 beds (skilled nursing home or intermediate care facility); or 5 bedroom accommodations (board and care facilities).

2. The operating loss must have occurred during a specific period of time. Refer to HUD Handbook 4470.1 for the operating loss period and deadlines for application.

3. The loss loan must not exceed the amount of the operating loss.

B. Definition of Operating Loss. A negative difference between project income and project operating expenses constitutes an operating loss. The following operating expenses may be included: taxes, interest on the mortgage debt, mortgage insurance premiums, hazard insurance premiums, maintenance, salaries, supplies, and other expenses for project operation. The following payments and charges may not be included: mortgage principal payments, depreciation, payments to the reserve for replacement account, mortgagee fees, and charges incurred in connection with the application for the OLL. Projected or anticipated losses are not eligible. In a case where the project has not reach sustaining occupancy, only current losses may be funded. The loan proceeds needed to cover deficit situations will be escrowed until sustaining occupancy is reached.

24-3. Preliminary Discussions for Operating Loss Loan. At the written request of the mortgagor, Field Office representatives shall meet with the mortgagor to conduct informal, preliminary discussions.

A. Attendance shall include representatives from Loan Management, Valuation, and Mortgage Credit, and the Director of Housing Development or their designee.

B. Loan Management should be prepared to discuss the competency of project management and the project's ability to carry additional debt, including the prospect of resolving any financial and physical difficulties.

24-4. Field Office Processing of Formal Application. If the mortgagor decides to submit a formal application, processing of the application will be done jointly by the Mortgage Credit, Valuation, and Loan Management Branches. The Director of Housing Development or his/her designee shall make a final review.

A. The Loan Management Branch shall review the competency and responsibility of project management and the project's ability to carry additional debt, including the prospect of resolving any financial and physical difficulties, and shall forward a memorandum stating its findings and recommendations to the Mortgage Credit staff for inclusion in the Mortgage Credit binder.

B. The Mortgage Credit examiner shall prepare a memorandum to the Director of Housing Development recommending approval or rejection of the operating loss loan request and obtain the concurrence of the Loan Management Branch. In deciding whether to concur in the case of a project with Section 8 project-based assistance, the Loan Management Branch shall consider the availability of Section 8 reserve funds to support the loan.

C. In those infrequent instances where operating loss loans are used to compensate for lack of sustaining occupancy which exists at the time of application, all or part of the loan proceeds shall be held in escrow by the mortgagee until the project has reached sustaining occupancy. In these cases there must be evidence that sustaining occupancy will be reached within a reasonable period of time. These funds shall be released from the escrow only with prior approval from the Loan Management Branch Chief. The method of disbursement from the operating loss loan escrow is as follows:

1. The mortgagor must submit to HUD:

   a. Monthly income and expense statements, signed by a principal of the mortgagor entity and approved by the mortgagee. The owner's monthly statements must contain the following acknowledgement:

WARNING: 18 USC 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document of writing containing any false, fictitious, or fraudulent statement or entry, in any manner within the jurisdiction of any department or agency of the United States, shall be fined not more that $10,000 or imprisoned for not more than five years, or both.

   b. Quarterly income and expense statements prepared and certified to by a CPA must be submitted to the Field Office within 60 days of the end of each quarter. This requirement will continue until all losses have been substantiated as actual losses by an audited statement. This must be a condition of the commitment. If the mortgagor has not submitted the quarterly statement by the due date, HUD will withhold approval of the disbursement until the statements are submitted. HUD will review the certified annual statement against the uncertified statements submitted by the mortgagor and make necessary adjustments in future disbursements.

2. Operating loss loan funds must be held in escrow and can only be used to offset current losses until it is evident the project is on sound footing. Once the project reaches sustaining occupancy, any balance remaining in the escrow must be held until sustaining occupancy is maintained for a one-year period.