CHAPTER 10: SUBSEQUENT LOANS *[7 CFR 3560.73]* AND LOANS FOR FINAL PAYMENTS *[7 CFR 3560.74]*

10.1 INTRODUCTION

The Agency may extend additional credit to a borrower for a Multi-Family Housing project initially financed by the Agency in the form of a subsequent loan. Subsequent loans may be made to current borrowers to complete, improve, repair, or make modifications to a Multi-Family Housing project or to finance equity to avert prepayment of a Multi-Family Housing project. In special circumstances, a subsequent loan may be used to add units to a project to provide access for persons with disabilities.

As the average age of properties in the Agency's portfolio increases, Loan Processing Staff are likely to encounter a growing number of subsequent loan requests from borrowers who have projects with immediate capital replacement needs, but insufficient reserve funds to meet those needs. Because subsequent loans increase project debt, the Agency must pay particular attention to ensuring that projects offer sufficient security to protect both the Agency's subsequent and initial loans in the event of default.

This chapter provides guidance to Loan Originators in evaluating whether approval of a subsequent loan is the appropriate action to take on a project. This evaluation must include an analysis of the applicant's management performance, as well as an analysis of the project's ability to support the additional debt service to cover the subsequent loan. Such an evaluation must also be made if a borrower wishes to assume a subsequent loan with non–Agency debt.

This chapter also covers the circumstances under which the Agency will make subsequent loans and describes how the procedures for underwriting and processing these loans differ from initial Multi-Family Housing loans.

A loan request to add units to an existing project because of a need for additional units is considered to be a second phase of a project and an initial loan, not a subsequent loan. Such loans to add new units compete for funding with all other initial Multi-Family Housing loans and are processed and underwritten in the same manner as initial Multi-Family Housing loans.

10.2 OVERVIEW

Subsequent loans may be made to current borrowers for a project with Agency financing to:

- Complete, improve, repair, or make modifications to the project.
- Finance equity to avert prepayments of the project. Such loans are discussed in detail in Chapter 15 of HB-3-3560.
- As a last resort, when modification of existing units is not possible, develop additional units to provide access for persons with disabilities. Such units do not

compete with other projects under the Notice of Funding Availability (NOFA) system.

A. Loans for Existing Units

A subsequent loan for existing units might be appropriate to:

- Complete needed repairs and rehabilitation work;
- Replace obsolete units (no additional units may be added to the original number of units); and
- Complete a project when there have been unforeseen factors beyond the owner's control, design changes that were required by the Agency or local Government, or changes in financing that was approved by the Agency (for example, where the cost of completing the project has escalated due to unexpected and prolonged inclement weather, which caused excessive delays in constructing the project, or where unexpected additional fees have been applied by the local Government). Subsequent loan funds may not be used to reimburse an owner for additional contributions that were made to complete a project.

If a subsequent loan is made, the borrower equity and initial operating capital contribution requirements apply.

- Subsequent loans for repair and rehabilitation do not compete for funding, and borrowers can apply for a subsequent loan at any time.
- The processing of subsequent loans for repair or rehabilitation typically begins when the Agency and the borrower identify the need for improvements at a project as a result of monitoring or servicing actions. Subsequent loans for this purpose are prioritized, selected, and processed in accordance with Agency instructions. States must categorize subsequent loan requests in accordance with Paragraph 10.3.

B. Loans Made with Conventional Financing

When a borrower wants to obtain a subsequent loan from a conventional lender, the Agency must approve the loan. In evaluating whether to approve the loan, the Agency will apply the underwriting criteria of applicant eligibility, project eligibility, reasonable costs, project feasibility, and security described in Paragraph 10.11.

SECTION 1: QUALIFYING FOR SUBSEQUENT LOANS

10.3 ELIGIBILITY, LOAN PURPOSES, AND PRIORITIES

A. Project Eligibility

As soon as it becomes evident that a subsequent loan request may be made, the Loan Originator must make an evaluation of the project in accordance with Chapter 6 of HB-3-3560. This evaluation will determine whether the additional commitment that such a loan represents is in the best interest of the Agency and the tenants. If this analysis concludes that the project is no longer suitable program property, the subsequent loan must not be made.

B. Eligible Loan Purposes

The provisions of 7 CFR 3560.53 and 7 CFR 3560.54, describing permitted and restricted loan purposes, apply to subsequent loans. Additional guidance specific to subsequent loans is provided at 7 CFR 3560.73.

The annual funding notice to the States, RD Instruction 1940-L, specifies the funds available for rehabilitation and new construction.

C. Repair and Rehabilitation Loan Funds

Subsequent loan requests for repair and rehabilitation are funded in accordance with guidance provided by the Agency. Loan Originators must categorize loan requests as follows:

- **Health and safety concerns.** Projects with outstanding health and safety deficiencies.
- **Inventory properties.** Projects that are in inventory or that need an additional loan to fund an approved workout agreement.
- **Deferred maintenance and Fair Housing compliance.** Projects with deferred maintenance and Fair Housing compliance deficiencies.

10.4 DESIGN REQUIREMENTS

All improvements, repairs, and modifications made as part of a subsequent loan must be in accordance with RD Instructions 1924-A and 1924-C.

The Loan Originator must require that the loan applicant obtain appropriate architectural services whenever any of the following conditions exist:

- New enclosed habitable space is being added;
- Architectural services are required by State law; or
- The Agency determines that the work being performed requires architectural services. This should include any work involving the structural, mechanical, plumbing, or electrical systems of a residential building, or requires a building permit from a local building jurisdiction.

The specific architectural service should be as deemed appropriate for the type and scope of work involved in the project.

10.5 ENVIRONMENTAL REQUIREMENTS

Subsequent loans are subject to the same environmental requirements as initial loans. Chapter 3 and RD Instruction 1940-G provide further details on environmental requirements.

10.6 LOAN LIMITS

The requirements for initial loans regarding loan amounts, borrower equity contribution, rates and terms, and initial operating capital as presented in Chapter 5, also apply to subsequent loans. The requirements for borrower equity and initial operating capital are specified below.

A. Borrower Equity Contribution

Loan applicants requesting subsequent loans must make an equity contribution consistent with the percentage required for the original loan. When determining the necessary equity contribution, any increase in the value of the property since the initial loan was made cannot be counted as a borrower equity contribution. However, additional initial investment on the initial loan may be credited toward the required investment on the subsequent loan. Exhibit 10-1 presents two examples showing the procedures for determining a borrower's required equity contribution.

B. Initial Operating Capital

Initial operating capital is required for subsequent loans to complete the original project, but is not required for subsequent loans to repair or improve an existing housing project.

Exhibit 10-1
Calculating Borrower Equity Contributions—Two Examples

***Example 1*:** Borrower Smith has an original loan from the Agency of $712,500, on which he paid a 5% equity requirement of $37,500. If he were to request a subsequent loan for $50,000, he would be required to provide a 5% equity contribution of $2,500 as follows because he has no excess equity in the first loan:

Calculating initial loan and equity	
Security value of initial loan	$750,000
Equity contributed to initial loan (5%)	$37,500
Initial Agency loan	$712,500
Calculating subsequent loan and equity	
Security value of subsequent loan	$50,000
Equity required for subsequent loan (5%)	$2,500
Subsequent Agency loan	$47,500
Determining whether equity requirement for subsequent loan has been met	
Security value of combined loans	$800,000
Total 5% equity required	$40,000
Equity contributed to initial loan	$37,500
Balance equity required for subsequent loan	$2,500

Example 2: Borrower Jones has an original loan of $712,500, on which he made an equity contribution of $40,000 (his land was worth $40,000, which is more than the 5% contribution required). If he were to obtain a subsequent loan for $50,000, he would not be required to contribute any additional equity, since the $2,500 he would ordinarily be required to contribute was already provided as part of the original loan:

Calculating initial loan and equity	
Security value of initial loan	$750,000
Equity contributed to initial loan (5%+)	$40,000
Initial Agency loan	$710,000
Calculating subsequent loan and equity	
Security value of subsequent loan	$50,000
Equity required for subsequent loan (5%)	$2,500
Subsequent Agency loan	$50,000
Determining whether equity requirement for subsequent loan has been met	
Total security value of combined loans	$800,000
Total 5% equity required	$40,000
Equity contributed to initial loan	$40,000
Balance equity required for subsequent loan	$0

10.7 RATES AND TERMS

Subsequent loans are amortized over a period not to exceed the lesser of the economic life of the housing being financed or 50 years, and are paid over a term not to exceed the lesser of the economic life of the housing or 30 years from the date of the loan.

10.8 RESTRICTIVE-USE PROVISIONS

Projects receiving subsequent loans are also subject to additional restrictive-use provisions in accordance with 7 CFR 3560.662.

A. Extension of Restrictive-Use Provisions

It is the Agency's policy that in exchange for providing Agency financing to a project through a subsequent loan, the project should be made available for low-income occupancy for an extended period beyond what the initial loan required. When a subsequent loan is made, a new 20-year restrictive-use period on the project begins as of the date of loan closing.

B. Prepaying Projects

Subsequent loans made to nonprofit organizations or public agencies to avert prepayment or to finance equity to avert prepayment will be subject to the restrictive-use provisions established in 7 CFR part 3560, subpart N and described in Chapter 15 of HB-3-3560. These restrictions require the borrower to continue housing eligible very low-, low-, and moderate-income households for the remaining useful life of the project; unless the Agency determines that there is no longer a need for the project.

SECTION 2: APPLICATION SUBMISSION AND PROCESSING

10.9 ACCEPTING APPLICATIONS

Subsequent loans for repairs or rehabilitation are funded from a separate allocation and do not compete for funding with new construction loans under the NOFA system. These requests are prioritized and funded at the National Office level in accordance with guidance provided by the National Office. Nevertheless, the Loan Originator must complete underwriting as would be done for any other loan to ensure the Agency's security and to establish the need for and eligibility of the loan under program requirements.

To complete the necessary underwriting, the Loan Originator must require the submission of the documentation and forms listed in Exhibit 10-2.

Exhibit 10-2
Documentation to be Submitted for a Subsequent Loan to Complete, Improve, Repair, or Modify an Existing Project

- *Form SF 424 A, Application for Federal Assistance;*
- *Form RD 1944-37, Previous Participation Certification;*
- The method of financing construction;
- Drawings, specifications, and a contract document that meets the requirements of Paragraph 9.10 B;
- The estimated total development cost, the cost per unit and the estimated loan amount (*Form RD 1924-13, Estimate and Certificate of Actual Cost);*
- Scope of work (not necessary for loans to complete a project);
- Signed statement regarding cost overruns;
- Information on architectural, engineering, and legal services and proposed contractor;
- *Forms RD 3560-30, Certification of No Identity of Interest (IOI)* and *RD 3560-31, Identity of Interest Disclosure/Qualification Certificate;*
- Change in related assistance;
- Detailed operating budget *(Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance);*
- Demonstrated ability of cooperative to self-manage, if applicable;
- Updated financial statements; and
- *Form RD 1910-11, Applicant Certification Federal Collection Policies for Consumer or Commercial Debts.*

When a borrower wants to apply for a subsequent loan for repair and rehabilitation, the Loan Originator must send the borrower a formal letter that:

- Lists all information required for a subsequent loan application (see Exhibit 10-2);
- Includes all forms that the applicant must complete and return;
- Specifies the deadline by which the information and forms must be returned;

- Defines what constitutes a complete application (all information and forms are submitted, and all forms are signed); and

- Invites the applicant to attend a meeting to discuss the subsequent loan application with the Loan Originator.

10.10 SETTING DEADLINES AND EVALUATING COMPLETENESS

A. Submission Deadlines

While subsequent loans to repair or rehabilitate existing units are processed in accordance with loan priorities established by the Agency, Loan Originators should set submission deadlines based upon the timing of the subsequent loan request. However, any deadlines must allow the applicant reasonable time to gather and prepare the necessary documentation, which is generally at least 30 days.

Once the deadlines have been established, the Loan Originator must inform the applicant that failure to meet the deadlines may result in the applicant losing their place in line for funding or may cause the applicant to face serious servicing consequences as a result of the repair and rehabilitation work being delayed. Chapter 10 of HB-3-3560 describes the servicing consequences in detail.

B. Completeness Requirements

To be considered complete, loan applications must meet the following requirements:

- All information detailed in Exhibit 10-2 must be completed; and

- All required forms must be signed.

10.11 UNDERWRITING

As for all loans, the Loan Originator must underwrite the loan to make sure that it is consistent with applicable program requirements and can be supported by the project. When underwriting applications for subsequent loans, Loan Originators will follow the basic procedures presented in Chapters 4 and 5.

To approve a subsequent loan application, the Loan Originator's underwriting analysis must show that the loan meets the Agency's underwriting standards. When underwriting the loan, the Loan Originator determines whether:

- The applicant is eligible for the loan;

- The project is eligible for the loan;

- The proposed project costs are reasonable;

- The proposed project is financially feasible;

- The Agency's interests are secure; and
- The project meets suitability requirements in accordance with Chapter 6 of HB-3-3560.

The underwriting analysis for subsequent loans differs in several respects from the analysis for initial loans.

A. Applicant Eligibility

Applicants for subsequent loans must be current borrowers under the program and must meet all eligibility requirements.

B. Project Eligibility

A project must meet the eligibility requirements described in Chapter 4 for it to be eligible for a subsequent loan. However, the following rules apply with respect to the location of a project requesting a subsequent loan:

- A project for which a subsequent loan will be used to make necessary repairs or improvements to the property or to avert prepayment may be located in an area that has changed from rural to nonrural and need not be in a designated place.
- The Administrator may approve a subsequent loan in a place that is not on the list of designated places as a servicing action.

C. Reasonable Costs

As for all Agency loans, the projected costs as shown on *Form RD 1924-13* must be reasonable and comparable to costs of similar work done in the area. The guidance provided in Chapter 3 applies in making this determination. If the evaluation shows that project costs are not reasonable and comparable, the applicant should be contacted to determine whether project costs can be reduced to a level determined to be reasonable. If not, the Loan Originator must not recommend approval of the loan.

D. Project Feasibility

1. Appropriate Scope of Work?

For subsequent loans for repairs or rehabilitation, the Loan Originator must schedule a unit-by-unit inspection of the project as part of the underwriting process. When possible, the State Architect should participate in this inspection and review the cost estimate and scope of work. The purpose of the inspection is to determine whether:

- The loan is necessary;
- The loan is for a correct amount; and

- The scope of work is appropriate.

2. Financial Feasibility

When evaluating a subsequent loan request for rehabilitation, the Loan Originator must determine whether the project has the financial capacity to support the additional debt service. For projects that have been experiencing vacancies, financial feasibility should be closely examined. If the project is experiencing financial difficulties due to market conditions or poor management, the subsequent loan should not be approved because it could result in additional loss to the Government. In making this determination, the Loan Originator may take into account the past performance of the loan applicant and the extent to which the applicant has exhibited the ability and intent to effectively manage the project. If the applicant has a history of poor performance at managing the property, the loan should not be approved, and some other servicing action, such as a transfer or workout agreement, should be considered. Chapters 7 and 10 of HB-3-3560 provide details on these servicing actions.

In considering any subsequent loan, the Loan Originator must establish that the project rents will be able to withstand the additional debt that will be placed on the project by the subsequent loan. The Loan Originator must analyze the budget in *Form RD 3560-7* submitted with the loan request and determine that the subsequent loan will not require rents to increase by so much that they become unaffordable to existing tenants based on their incomes and the availability of rental assistance, and will not exceed the Conventional Rents for Comparable Units (CRCU) standard. The Agency may only approved rents above the CRCU in limited circumstances, as described in Chapter 3, paragraph 3.20 B.

Adequacy of Security

Example 1. Borrower Johnson has applied for a subsequent loan in the amount of \$350,000 to make repairs and improvements. His current outstanding debt to the Agency is \$500,000. The appraisal comes back valuing the property with improvements at \$650,000, therefore only supporting a loan of \$150,000 (\$650,000 – \$500,000). The project does not provide sufficient security to support the \$350,000 loan. The Loan Originator may recommend approval of a \$150,000 loan.

Example 2. Borrower Olson has applied for a subsequent loan in the amount of \$350,000 for repairs. Her current outstanding debt to the Agency is \$600,000. The appraisal comes back valuing the property with improvements at \$1 million. The Loan Originator may recommend approval of the \$350,000 loan.

E. Security

1. Adequacy of Security

The Loan Originator must evaluate whether the project can generate sufficient income at rents affordable to the tenants and not in excess of CRCU to cover the additional expense of the additional debt service required by a subsequent loan. If this is not possible, the Loan Originator must not recommend approval of the loan. In such an event, some other servicing action in conjunction with the subsequent loan, such as a transfer or workout agreement, must be initiated. Chapters 7 and 10 of HB-3-3560 provide details on these servicing actions.

2. Participation Loans

When an applicant is planning to use other funds or financing in conjunction with a subsequent loan from the Agency, the requirements and procedures of Chapter 6.

10.12 LOAN APPROVAL AND CLOSING

A. General Procedures

Loan Originators will follow the loan approval and the loan closing procedures detailed in Chapter 8.

B. Implementing Restrictive-Use Provisions

The required restrictive-use language for subsequent loans to repair and rehabilitate projects must be appended to the mortgage referencing all notes. The term of the new provisions begins on the date of loan closing.

10.13 RELOCATION PLANS

Subsequent loans that are made for major repair and rehabilitation may require the temporary relocation of tenants while the project is undergoing work. The applicant must provide a plan and financial assistance for relocation of displaced persons from a site on which a project will be located. Paragraph 3.19 details the requirements for relocation plans and assistance.

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SECTION 3: FINAL PAYMENTS

10.14 FINANCING FINAL PAYMENTS

The Agency may finance final payments for borrowers holding existing loans for which the Agency approved an amortization period that exceeded the term of the loan.

Financing may be made if current market studies show that a need for low-income rental housing still exists for that area and one of the following conditions has been met:

- It is more cost efficient and serves the tenant base more effectively to maintain the current project than to build a new project in the same location; or

- The project has been maintained to such an extent that it warrants retention in the current portfolio because it can be expected to continue providing decent, safe, and sanitary affordable rental units for the term of the new loan.

The term of the Agency financing for final payments will not exceed 20 years.