



REGULATORY INTERPRETATION 2003-RI-01

Date: February 6, 2003

Subject: Requirements for Subsidy Recapture and Retention Agreements and Reasonable Collection Efforts of the Affordable Housing Program (AHP) Regulation

Request Summary:

A Federal Home Loan Bank (FHLBank) has asked whether, in the event of noncompliance with AHP requirements, a member's exercise of the remedies provided under its subsidy recapture and retention agreements with a project owner would be sufficient to satisfy the "reasonable collection efforts" requirement under section 951.12(a)(2) of the AHP regulation, or whether the member also must obtain and foreclose on a lien on the property for the amount of the AHP subsidy in order to satisfy the "reasonable collection efforts" requirement.

Conclusion:

The AHP regulation does not specifically require a member to obtain a lien on the property, or if obtained, to foreclose on such lien. Obtaining and foreclosing on a lien is an individual business judgment that the member must make. The interplay of a member's decision not to obtain a lien and the "reasonable collection efforts" provision of section 951.12(a)(2), is case specific and cannot be resolved within the context of a Regulatory Interpretation. However, a member's decision not to obtain and foreclose on a lien will not, in and of itself, be a sufficient basis to conclude that the member did not satisfy the "reasonable collection efforts" provision.

Background:

In 1999 and 2000, the FHLBank approved AHP direct subsidies for the construction of three rental housing projects involving the same member and project owner, with the projects to be located on tribal trust land leased to the project owner by the tribe. The FHLBank disbursed the AHP subsidy through the member for one of the projects, which has since been completed and occupied. For that project, the member and project owner recorded a promissory note for the AHP subsidy and a recapture and retention agreement. The member did not obtain a lien on the property, *i.e.*, a leasehold mortgage in this case, to secure any AHP subsidy repayment obligation that might arise in the event of noncompliance with AHP requirements or sale or refinancing of the project.

The FHLBank has not yet disbursed the AHP subsidies to the other two approved projects, which were completed with other funds¹ and currently are occupied. The member has merged into a non-member financial institution, which is attempting to transfer the two projects to another member institution. For the two projects, the FHLBank proposes to use a subsidy recapture and retention agreement with the new member that would be similar to the one used with the funded project. The proposed agreement would incorporate the project owner's obligation to repay the AHP subsidy under certain circumstances, as well as the other provisions required in section 951.13(d)(2) of the AHP regulation. *See* 12 C.F.R. § 951.13(d)(2).

The FHLBank has asked whether exercise by the member of the remedies provided under the proposed agreement would be sufficient to satisfy the "reasonable collection efforts" requirement under section 951.12(a)(2) of the AHP regulation, or whether the member also must obtain and foreclose on a leasehold mortgage on the property for the amount of the AHP subsidy in order to satisfy the "reasonable collection efforts" requirement. The FHLBank argues that a member should not be required to obtain and foreclose on a leasehold mortgage on tribal land because of the additional costs and time delay associated with obtaining approval of the leasehold mortgage by the Bureau of Indian Affairs, and the costs of paying off the senior liens and difficulty of selling the leasehold mortgage upon a foreclosure.

Analysis and Discussion:

Section 951.13(b)(3)(ii) of the AHP regulation provides that a member shall have in place an agreement with a rental project owner in which the owner agrees to repay AHP subsidies to the member in the event of noncompliance with AHP requirements, in accordance with the requirements of section 951.12. The member, in turn, is required to repay the subsidies to the FHLBank. *See* 12 C.F.R. § 951.13(b)(3)(ii). Section 951.13(d)(2) of the AHP regulation provides that a member receiving AHP direct subsidy to finance a rental project must ensure that the project is subject to a deed restriction or other legally enforceable retention agreement or mechanism requiring, among other things, that the project's rental units will remain occupied by and affordable for income-targeted households for the 15-year retention period, and the subsidy will be repaid to the FHLBank in the event of a sale or refinancing of the project prior to the end of the 15-year retention period, unless the project continues to be subject to a 15-year retention mechanism. *See* 12 C.F.R. §§ 951.1 (definition of "retention period") and 951.13(d)(2).

Section 951.12(a)(2) separately provides that a member generally has a duty to recover from the rental project owner, and repay to the FHLBank, the amount of any AHP subsidies that, as a result of the project owner's actions or omissions, is not used in compliance with the terms of the AHP application and the regulatory requirements, except that the member is not be liable to the FHLBank for the return of amounts that cannot be recovered from the project owner through "reasonable collection efforts" by the member. *See* 12 C.F.R. § 951.12(a)(2). Finance Board staff guidance states that "reasonable collection efforts" will depend on the facts and circumstances of each situation, and may involve negotiation and pursuit of legal remedies against a project owner, in addition to the enforcement of a member's rights under a mortgage or other lien on the project. *See* Federal Register Notice 1997-N-10 (*Questions and Answers Regarding the Affordable Housing Program, Remedial Action for Noncompliance (Section 960.12)*, Q1 (62 Fed. Reg. 66977, 66979 (Dec. 23, 1997)))

¹ The general contractor for these projects will reimburse his costs with the AHP subsidies.

The AHP regulatory provisions do not specifically require a member to obtain a lien or deed of trust on the property, such as a leasehold mortgage, or other type of financial protection mechanism such as a guarantee, letter of credit or insurance, for the amount of the AHP subsidy. Nor do the regulatory provisions specifically require a member to foreclose on a lien or deed of trust, if obtained. Whether a member obtains a lien or deed of trust on the property, or other type of financial protection mechanism, to protect itself from potential liability for repayment of the AHP subsidy, is an individual business judgment that the member must make. Similarly, the decisions on the types of reasonable collection efforts to take, including exercise of the remedies provided under the subsidy recapture and retention agreements and foreclosure if a lien or deed of trust exists, are individual business judgments that the member must make.

The interplay of a member's decision not to obtain a lien or deed of trust, or other type of financial protection mechanism, and the "reasonable collection efforts" provision of section 951.12(a)(2), is case specific and cannot be resolved within the context of a Regulatory Interpretation. However, a member's decision not to obtain a lien or deed of trust, or other type of financial protection mechanism, will not, in and of itself, be a sufficient basis to conclude that the member did not satisfy the "reasonable collection efforts" provision. Nor will a member's decision not to foreclose on a lien or deed of trust, in and of itself, be a sufficient basis to conclude that the member did not satisfy the "reasonable collection efforts" provision.

<p>A Regulatory Interpretation applies only to the particular transaction or activity proposed by the requestor, may be relied upon only by the requestor, and is subject to modification or rescission by action of the Board of Directors of the Finance Board. 12 CFR part 907.</p>
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