HUD AND COOPERATIVE MORTGAGE PAYOFFS

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In today's highly competitive lending market where interest rates seem to drop daily, many cooperatives are finding it advantageous to refinance their HUD insured mortgage(s). Some refinance so as to tap into their equity for capital improvements to the property, others simply to lower the mortgage payment to decrease operating costs. However, many refinance because paying off the existing HUD insured mortgages terminates the regulatory agreement with HUD, thereby freeing the cooperative from HUD oversight.

Decades ago, when the cooperative housing movement was at its strongest, many cooperatives found it difficult to obtain financing for their developments. HUD became the savior for many cooperatives by insuring their mortgages. Lenders were more willing to finance cooperative projects with the assurance that if the cooperative defaulted on the mortgage payments, HUD would be responsible for paying off the loan. In exchange for insuring its mortgage payments, the cooperative would agree to pay HUD (usually as part of its monthly mortgage payment) a mortgage insurance premium, and would further agree to enter into a "regulatory agreement" with HUD.

The regulatory agreement generally grants HUD control over the cooperative by restricting the operation of the cooperative to ensure compliance with HUD policies. The cooperative remains under "the thumb" of HUD as long as the regulatory agreement is in effect. The penalties for a cooperative's violation of the regulatory agreement can be harsh, and include forfeiting the property to HUD. Only when the regulatory agreement is terminated can a cooperative truly operate as an unrestricted and "free" corporate entity, hence many cooperatives view refinancing as a road to freedom from HUD control.

Most HUD regulatory agreements do not prescribe a procedure for its termination upon payment of the insured mortgage(s). Therefore, cooperatives are left without guidance as to how to formally terminate their relationship with HUD. HUD maintains, with no legal basis, that is must approve the payoff of the existing HUD insured mortgage(s) before the regulatory agreement can be terminated. Hence, the cooperative can expect resistance from HUD, which will insist, again, with no legal basis, that the cooperative satisfy numerous requirements before the regulatory agreement can be terminated. HUD has even gone as far as stating that it will not approve a mortgage payoff, unless the payoff decision had been submitted to a vote and been approved by every member of the cooperative (if a single member dissents or does not vote, HUD will not approve the payoff).

Obviously, such a requirement is unrealistic, especially for cooperatives with a large membership. When pressed for its legal authority to impose such requirements, HUD's response had been that they are "internal office policies."

The fact of the matter is that the law, specifically 24 C.F.R 213, states that all rights under the regulatory agreement shall terminate upon payment in full of the insured mortgage. A section 213 cooperative's only obligation is to give HUD notice of the prepayment, on a form prescribed by HUD, within 30 days from the date of prepayment. Therefore, a cooperative is not required to obtain HUD “approval” of a mortgage payoff, but rather simply to give HUD notice of the payoff. Although, if HUD requests that the cooperative provide them with easily obtainable information related to the payoff, such as the minutes of the meeting at which the payoff was approved by the Board of Directors, the cooperative should probably comply simply to save time and effort by avoiding confrontation (and litigation if HUD takes the position that it will not discharge the cooperative from the regulatory agreement without such information). However, section 213 cooperatives must be aware of their legal obligations so as to avoid being bullied by HUD.