

CHAPTER 12. PROMISSORY NOTES

12-1. WHAT THEY ARE AND THEIR USES. Promissory notes are used to evidence a debt of the mortgagor entity incurred as a result of the development of an insured multifamily project and must receive HUD approval prior to their issuance. (As used herein, "Promissory Notes" refers to surplus cash notes and or residual receipts notes.)

A. Common types of debt:

1. Discounts, financing fees, and/or extension fees paid by a third party on behalf of the mortgagor entity.

2. A secondary mortgage securing a loan from a government or nongovernment source.

3. Deferment of the general contractor's profit in return for the mortgagor's agreement to pay upon completion of the project:

a. Such arrangements must be disclosed by the parties before initial endorsement.

b. Such arrangements are permitted only under those sections of the National Housing Act that do not provide for BSPRA.

4. Amount by which the land acquisition cost exceeds HUD's warranted price of land fully improved.

B. Promissory notes are not to be executed for costs disallowed in the cost certification review.

C. Promissory notes are not executed to determine the distribution of surplus cash, nor are they issued to establish an equity interest.

12-2. MANAGEMENT AND DEVELOPMENT STAFF DUTIES. To coordinate the identification and handling of development-related liabilities and expenditures:

A. The Development Division in the Field Office is responsible for approving the issuance of a promissory note before final endorsement.

B. Approved copies of the promissory note will be filed in the Washington and Office Dockets.

(12-2) C. The Mortgage Credit Branch will send the Housing Management Division a list of all promissory notes approved before the final endorsement of the mortgage. The list must include the name of the payee, the amount and the reason for the issuance.

D. Prepayment of the promissory notes from sources other than the project is permitted without HUD approval.

E. Payments for promissory notes will be made only as indicated in the applicable Regulatory Agreement.

12-3. EFFECT ON COST CERTIFICATION. HUD-approved promissory notes affect cost certification and mortgage computation, with respect to costs to be certified, in the following ways.

A. Hard and soft costs for which promissory notes were issued may be recognized to the extent there are savings in the mortgage. At final endorsement, that portion of the note recognized for cost certification purposes must be paid in cash.

B. Promissory notes issued for construction costs listed in the "paid" or "to be paid" column of Form HUD-92330, with the exception of builder's profit on profit motivated projects involving an identity of interest between the mortgagor and general contractor, must either be paid at final endorsement or a cash escrow established to liquidate the debt; otherwise, these items must be considered unpaid costs. Construction costs evidenced by any HUD Promissory Note and listed on Form FHA-2023/2455 must be considered as unpaid costs. Refer to paragraph 11-14.

12-4. TYPE OF PROMISSORY NOTE USED--depends on the type of mortgagor entity and the Regulatory Agreement.

A. ENTITY USE

1. Nonprofit and/or Cooperative Residual Receipts
Entities Note, Form FHA-1710

2. Limited Distribution Entity Residual Receipts
Note, Form FHA-1712

3. All other entities Promissory Note,
Form FHA-2223

(12-4) B. Form FHA-1710, Residual Receipts Note (Nonprofit and/or Cooperative Mortgagors).

1. Principal and interest shall be due and payable on the maturity date of the HUD insured mortgage.
2. If the HUD insured mortgage is prepaid in full, the holder of the residual receipts note has the right to declare the whole principal sum or any balance with interest immediately due and payable.
3. Prepayment to principal and interest may be made only from the residual receipts fund as defined in the Regulatory Agreement and only after obtaining written approval from HUD or from sources other than project income, i.e., syndication proceeds.
4. Prepayments may be made only after final endorsement of the insured mortgage and after a semiannual or annual fiscal period.
5. Any unauthorized prepayment accepted by the payee must be held by the payee in trust for the project.
6. The residual receipts note is nonnegotiable and may not be sold, transferred, assigned, or pledged by the payee except with the prior written approval of the Commissioner.
7. Presentation, demand and notice of demand, nonpayment and protest of the residual receipts note are waived.
8. Interest on the note must not be compounded.

C. Form FHA-1712, Residual Receipts Note, (Limited Distribution Mortgagor). The conditions and limitations are the same as Form FHA-1710 except that no prepayment to interest is permitted.

D. Form FHA-2223, Promissory Note, (All other entities). Conditions and limitations are the same as B., above, except that:

1. Provisions may be made for interest payments only semiannually or at the end of a fiscal period. However, any interest not paid shall

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(12-4) not create a default in the terms of the note but accrue and be payable in full when the note matures.

2. Prepayment of principal or any payment of interest must be limited to surplus cash as defined in the Regulatory Agreement or from sources other than project income, i.e., syndication proceeds.

3. Any unauthorized prepayments, as determined by HUD, shall be the responsibility of the payor to return to the project.

E. The interest rate on the promissory note is negotiable between the payee and payor.

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