

## PART I

## CHAPTER 1. INTRODUCTION

- 1-1. LEGAL AUTHORITY AND BACKGROUND OF THE SECTION 312 REHABILITATION LOAN PROGRAM. The Rehabilitation Loan Program was first enacted by Congress as Section 312 of the Housing Act of 1964, Public Law 88-560, 42 U.S.C. 1452b. The Section 312 program was designed to assist in eliminating and preventing the development and spread of slums and blight, to encourage localities and property owners to upgrade and preserve existing neighborhoods and to rehabilitate private properties. The program operates as a cooperative venture between the Federal government, which furnishes the loan funds, and localities, which process loans.

Section 312 authorizes direct Federal loans to eligible borrowers whose repayments, together with appropriations and other income, form a "revolving fund" from which other Section 312 loans are made (subject to Congressional approval in an annual appropriation act). Grants or forms of rehabilitation subsidy other than direct loans are not authorized by Section 312.

- 1-2. ORGANIZATION OF HANDBOOK. The Handbook is divided into the following major parts:

Part I Introduction, which includes the introductory information and definitions in this chapter, as well as chapters on the general terms of Section 312 loans and the costs which may be included in 312 loans, including special requirements for refinancing;

Part II Processing a Section 312 Loan, which includes chapter on initial screening of potential borrowers, verifying information on the prospective borrower's finances and property, dealing with preconstruction and contract issues, final underwriting, as well as loan settlement, construction inspections and progress payments, loan administration, refinancing and other Federal requirements;

Part III Program Administration Guidelines for Local Processing Agencies, which includes chapters on local loan approval and staffing a Section 312 program and developing a program strategy;

Part IV Program Administration Guidelines for HUD Field Offices, which focuses on program monitoring; and

Appendix, which includes the required and suggested forms to be used in administering the program.

- 1-3. WAIVERS. The HUD Assistant Secretary for Community Planning and Development may waive any requirement of this Handbook not required by law, whenever it is determined that undue hardship would result from

applying the requirement and such application would adversely affect the achievement of the purposes of the Section 312 Program.

1-4. DEFINITIONS. The following are definitions of various terms used in this Handbook.

- a. "Accrued Construction Interest" means the interest that accrues on the Section 312 Rehabilitation Loan funds advanced during the construction period. Such interest is added monthly to the principal of the loan by HUD, pursuant to the term of the borrower's loan note.
- b. "Adjustable Rate Mortgage", or "ARM", means an instrument which secures a promissory note in which the interest rate and/or the monthly payment varies, according to pre-determined criteria, over the term of the loan, rather than remaining fixed throughout the term of the loan.
- c. "Amortization Effective Date", or "AED", means the first day of the month in which the loan begins amortizing, as specified in the promissory note, usually after the full loan amount has been disbursed to the borrower and construction is completed. The first payment is due on the first day of the first month following the Amortization Effective Date.
- d. "Application Fee" means the fee which borrowers must pay to HUD before funds can be released for construction for each approved Section 312 Loan application, which is \$200 for loans on single-family properties or \$300 for loans on all other properties.
- e. "Approving Officer" means the person who approves or disapproves Section 312 Rehabilitation Loans, who is either an authorized HUD official, or an individual in a locality designated by HUD as having Local Loan Approval Authority pursuant to an agreement between the locality and HUD.
- f. "Balloon Note" means a promissory note in which an unusually large payment of principal is due at the end of the term of the loan, rather than having the total principal amortized over the term of the loan.
- g. "Borrower" means one or more individuals, corporations, or partnerships who receive approval of a Section 312 Rehabilitation Loan. The borrower(s) must (collectively) own the property to be rehabilitated, and each owner must execute the legal documents evidencing and securing the loan.

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- h. "Cash Management Contractor" means the private company which is under contract to HUD to implement the Cash Management System for the Section 312 Loan Program.

- i. "Cash Management System" means the system for disbursing Section 312 Rehabilitation Loan funds. This system is designed to ensure that funds are disbursed efficiently to borrowers, and at the same time, that funds are not disbursed to borrowers before they are needed so that the government's outlays can be minimized. The system is also designed to ensure that management information on Section 312 Loan funds is readily available to HUD.
- j. "Community Development Block Grant Program", or "CDBG Program", means the program conducted under the provisions of the Housing and Community Development Act of 1974, as amended (42 U.S.C. 5301 et seq.), and the Code of Federal Regulations (24 CFR Part 570).
- k. "Congregate Housing Property" means a residential property in which some or all of the dwelling units do not contain kitchen facilities but which does have a central dining facility connected with it where meals can be served to the occupants. Congregate housing properties are considered investor-owned, multifamily properties for the purposes of this Handbook.
- l. "Corporation" means a legal entity duly organized as a for-profit or not-for-profit corporation under applicable state law which has current articles of incorporation that are on file with the appropriate state regulatory agency, and which has fulfilled all legal requirements for engaging in the business of owning land and renting property.
- m. "Dwelling Unit" means a residential space which, after rehabilitation, will qualify under the laws of the state and locality as a place of permanent habitation or abode for a family or one or more individuals. A dwelling in a congregate housing property need not contain a kitchen area but the property must contain or be connected to a central dining facility where meals can be served to the occupants of the dwelling units. A dwelling unit in a single room occupancy property need not contain a kitchen or a bathroom, but the property must have adequate bathroom facilities for the number of dwelling units.
- n. "Effective Gross Income" means an investor-owner's total rental income from the property minus a vacancy factor of at least five percent (5%) of the gross rental income. The vacancy factor should be raised if conditions in the neighborhood or locality so dictate.
- o. "General Partnership" - See definition of "Partnership".

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- p. "Graduated Payment Mortgage", or "GPM", means an instrument which secures a promissory note in which the interest rate and/or monthly payment increases at pre-determined times during the term of the loan, rather than remaining fixed.
- q. "Housing Assistance Plan", or "HAP", means the document prepared

- by a locality in accordance with the Community Development Block Grant Program regulations (24 CFR 570.306) in which the locality assesses its housing conditions as well as the housing assistance needs of its low and moderate income households, and uses this information to define its goals for providing housing assistance.
- r. "Housing Development Action Grant", or "HoDAG", means the program conducted under the provisions of Section 17 of U.S. Housing Act of 1937, as amended (42 U.S.C. 1437o), and the Code of Federal Regulations (24 CFR Part 850).
  - s. "Housing Quality Standards", or "HQS", means the Section 8 Existing Housing Quality Standards (24 CFR 882.109), which become the Local Rehabilitation Standards for localities which have not adopted any other rehabilitation standards and are participating in the Section 312 Program.
  - t. "HUD" means the U.S. Department of Housing and Urban Development.
  - u. "Incipient Deficiencies" means problems or defects with the property which, if not corrected, would reasonably be expected to deteriorate into actual deficiencies under the Local Rehabilitation Standards within two years.
  - v. "Interest Rate" means the stated rate of interest charged to borrowers on the outstanding principal balance of Section 312 Rehabilitation Loans. For owner-occupants with incomes not exceeding eighty percent (80%) of the area median income, the interest rate is three percent (3%) and for all other eligible borrowers the rate is based on the yield of government securities of comparable maturity. This rate may differ from the Annual Percentage Rate for Truth-in-Landing purposes, which is calculated under Federal Reserve Board regulations.
  - w. "Investor-Owner", or "Investor-Owned Property", means a borrower who owns a one-to-four dwelling unit property but does not occupy a dwelling unit in that property as a principal residence, or a borrower who owns a non-residential, mixed-use or multifamily property, regardless of whether he or she occupies a dwelling unit in that property as a principal residence. In addition, all corporations, partnerships, and other legal entities, except cooperatives, that own residential property are considered investor-owners.

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- x. "Limited Partnership" -- See definition of partnership.
- y. "Local Loan Approval Authority" means the authority granted to a locality by HUD which authorizes a named official, employed and designated by the locality, to approve loans for eligible residential and mixed-use properties containing one-to-four dwelling units after rehabilitation. Local Loan Approval Authority is granted by the execution of an agreement between HUD and the Chief Executive Officer in the locality.

- z. "Locality" means a unit of general local government which participates in the Section 312 Rehabilitation Loan Program.
- aa. "Local Processing Agency", or "LPA", means the public agency designated by the locality to operate the Section 312 Rehabilitation Loan Program and process loans on behalf of the locality. This term includes any individual, partnership or corporation acting under a contract with the LPA to perform certain tasks for the LPA in relation to the Section 312 program.
- bb. "Local Rehabilitation Standards" means any rehabilitation codes or standards adopted by a locality for the entire locality or the area in which the subject property is located. If no codes or standards have been adopted by the locality, the Housing Quality Standards established under the HUD Section 8 Existing Housing Program (24 CFR 882.109) become the Local Rehabilitation Standards. Rehabilitation work on properties financed with a Section 312 Loan must also meet the minimum requirements of the Cost Effective Energy Standards, established under 24 CFR Part 39, whether the locality has adopted its own codes or standards or uses the Housing Quality Standards.
- cc. "Low- and Moderate-Income Family" means a family whose total income does not exceed ninety-five percent (95%) of the median income for the area, as determined by HUD with adjustments for smaller and larger families, and as based on data from the most recently available U.S. Census. Income statistics meeting this definition are published by HUD pursuant to Section 235 of the National Housing Act. (It must be noted, however, that many of the income requirements in the Section 312 program, particularly those concerning the qualifications for three percent (3%) loans for certain owner-occupants of single-family properties, as well as the income requirements for tenants in multifamily properties, use eighty percent (80%) of the median income for the area as the income ceiling.)
- dd. "Low- and Moderate-Income Person" means a person whose income is within the limits defined in the definition of "Low- and Moderate-Income Family."

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- ee. "Master Servicer" means the private company which is under contract to HUD to serve as HUD's primary servicing agent for the Section 312 Loan Program, and to provide training and technical assistance to LPA's for the Section 312 Loan Program.
- ff. "May" means that the item is not required, but that it is a suggestion.
- gg. "Median Income for the Area" means the median income of the metropolitan statistical area established by the Office of Management and Budget, or, when applicable to an area outside a metropolitan statistical area, the median income of the

- non-metropolitan county. when comparing the income of the prospective borrower or tenant to the median income for the area, the median income for a family of corresponding size must be utilized.
- hh. "Mixed-Used Property" means property containing a combination of residential dwelling units and non-residential uses.
  - ii. "Minority Business" means a business controlled by a minority person(s) who controls at least 51% of the ownership of the business. In the case of a minority investor-owner, this means a person(s) who possesses at least 51% of the ownership of the dwelling unit(s) and controls its daily management and operations.
  - jj. "Minority Person" means persons, including but not limited to, Blacks, American Indians, Alaskan Natives, Hispanics, Asians and Pacific Islanders.
  - kk. "Multifamily Property" means property devoted solely to residential use containing five or more dwelling units.
  - ll. "Must" means that the item is a requirement, and that it is mandatory that it be undertaken.
  - mm. "Net Operating Income", or "NOI", means effective gross income (gross income minus projected vacancies) minus total operating expenses (excluding debt service).
  - nn. "Non-Residential Property" means property containing no dwelling units, but excluding churches or other structures to be used to promote religious interests.
  - oo. "Owner-Occupied" means a one-to-four unit property owned by a borrower whose principal residence is a dwelling unit in that property. Owner-occupancy applies only to individuals; property cannot be considered "owner-occupied" if the title is held by a corporation or partnership, even if one of the partners or a principal shareholder lives there.

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- pp. "Partnership" means a legal entity duly organized as a partnership (either general or limited) under the applicable law of a state which has fulfilled all legal requirements for engaging in the business of owning and renting real property. Two or more individuals who own property as joint tenants, tenants by the entireties, or tenants in common are not a partnership, unless so organized under state law.
- qq. "Public Body" means either a town, city, county or other unit of general local government, or an authorized special purpose unit of government.

- rr. "Rehabilitation" means the improvement or repair of an existing structure, or the improvement or repair of facilities in connection with an existing structure, and may include the provision of such sanitary or other facilities as are required by applicable Local Rehabilitation Standards. Rehabilitation may not include work so excessive as to be equivalent to new construction or reconstruction of the property, although "gut rehabilitation" may be considered rehabilitation if necessary, at least in part, to meet local rehabilitation standards.
- ss. "Rehabilitation Escrow Account" means an account that a locality must establish with a financial institution for the receipt and disbursement of Section 312 Rehabilitation Loan funds on behalf of borrowers.
- tt. "Rehabilitation Management Specialist", or "RMS", mean the staff person responsible for rehabilitation activities in a HUD Field Office, including the Section 312 Rehabilitation Loan Program. The Rehabilitation Management Specialist may act as the Approving Officer for Section 312 Rehabilitation Loans being made in a locality not covered by a Local Loan Approval Agreement, and may monitor Local Processing Agencies' activities under the Section 312 Rehabilitation Loan Program.
- uu. "Rent Regulatory Agreement" means the agreement which must be executed with all investor-owners of multifamily properties, as well as of mixed-use, single-room occupancy, and congregate housing properties with five or more dwelling units after rehabilitation, which regulates rent increases for at least five years by limiting the borrower's rate of return on his or her investment.
- vv. "Rental Rehabilitation Program" means the housing rehabilitation program conducted under the provisions of Section 17 of the U.S. Housing Act of 1937, as amended (42 U.S.C. 1437o), and the Code of Federal Regulations (24 CFR Part 511).

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- ww. "Risk Premium" means the one percent (1%) premium which must be paid by all borrowers as part of their monthly payments from the Amortization Effective Date for the life of the loan to help offset losses on Section 312 Loans.
- xx. "Section 312 Rehabilitation Loan", or "Section 312 Loan", or "312 Loan", means rehabilitation loans as authorized by Section 312 of the Housing Act of 1964, as amended (42 U.S.C. 1452b).
- yy. "Single-Family Property" means property devoted solely to residential use and having from one to four dwelling units after rehabilitation.
- zz. "Single-Room Occupancy Property" means a residential property in which some or all of the dwelling units do not contain individual

bathroom or kitchen facilities, but have access to bathroom facilities. Single room occupancy properties are considered investor-owned multifamily properties for the purposes of this Handbook.

- aaa. "Stable Monthly Income" means the borrower's verified gross income that is likely to continue, based on foreseeable economic circumstances.
- bbb. "Supplemental Financial" means any rehabilitation financing necessary to complete the rehabilitation of the property other than the Section 312 Rehabilitation Loan.
- ccc. "Underwrite" means the process of assessing the financial risks of a particular Section 312 Loan, which is done by the Approving Officer, based upon information supplied primarily by the Local Processing Agency. This underwriting must be based on a careful analysis of whether there is a need for rehabilitation and whether the requirements detailed in this Handbook are met, as well as of the likelihood that the prospective borrower will repay the Section 312 Loan, including the prospective borrower's ability to afford the loan and the prospective borrower's creditworthiness; the security available for the loan; the scope of the proposed rehabilitation work; and a certification of adherence to program requirements.
- ddd. "Urban Development Action Grant Program", or "UDAG Program", means the program conducted under Section 119 of the Housing and Community Development Act of 1974, as amended (42 U.S.C. 5301 et seq.), and the Code of Federal Regulations (24 CFR Part 570, Subpart G).
- eee. "Urban Homestead Neighborhood", or "Urban Homestead Area", means any geographic area for which HUD approval has been granted to a state or locality to conduct a local urban homesteading program

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that meets the requirements of Section 810 of the Housing and Community Development Act of 1974, as amended, and the regulations at 24 CFR Part 590.

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